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10-362

No. ———

In the Supreme Court of the United States

ESTATE OF LOUISE BLYTH TIMKEN (Deceased), *et al.*,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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September 14, 2010

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QUESTIONS PRESENTED

1. Is the grandfather clause for the GST Tax, which is set forth in Section 1433(b)(2)(A) of the Tax Reform Act of 1986, Pub.L. 99-514, a plain and unambiguous statute as determined by two separate Circuit Courts of Appeal or should the statute be considered ambiguous as determined by two other Circuits?

2. Is the constructive additions regulation, which is set forth in Treasury Regulation Section 26.2601-1(b)(1)(v), a valid regulation when it fails to harmonize with the plain language of the grandfather clause?

3. Assuming that the constructive additions regulation is valid, do the Petitioners fall outside the reach of the regulation so that they qualify for the protection of the grandfather clause?

LIST OF ALL PARTIES TO THE PROCEEDING

The following is a list of all of the Petitioners who seek review of the lower court's decision by virtue of this Petition:

1. Estate of Louise Blyth Timken;

2. Ward J. Timken and Joy A. Timken*, Co-Executors of the Estate of Louise Blyth Timken;

3. Henry H. Timken, Jr. Trust Fund A;

4. Henry H. Timken, Jr. Trust, Fund A1A fbo Alexander C. Timken;

5. Henry H. Timken, Jr. Trust, Fund A1B fbo Peter T. Toot;

6. Henry H. Timken, Jr. Trust, Fund A1C fbo Elizabeth Burnham Timken;

7. Henry H. Timken, Jr. Trust, Fund A2A fbo Susan M. Matthews;

8. Henry H. Timken, Jr. Trust, Fund A2B fbo Thomas Wesley Matthews;

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* Joy A. Timken was substituted for original Plaintiff W. R. Timken, Jr., who resigned as Co-Executor during the pendency of this case when he was appointed United States Ambassador to the Federal Republic of Germany by President George W. Bush.

9. Henry H. Timken, Jr. Trust, Fund A2C fbo Anna Virginie Corwin Timken;

10. Henry H. Timken, Jr. Trust, Fund A2D fbo Nicholas Timken;

11. Henry H. Timken, Jr. Trust, Fund A2E fbo John Henry Timken; and

12. Henry H. Timken, Jr. Trust, Fund A2F fbo Stuart Morgan Timken.

None of the Petitioners are corporations so no corporate disclosure statement is included herewith.

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The March 25, 2009, decision of the United States District for the Northern District of Ohio is reported at 630 F. Supp.2d 823, and is set out in the Appendix at p. 19a.

The April 2, 2010, decision of the United States Court of Appeals for the Sixth Circuit is reported at 601 F.3d 431, and is set out in the Appendix at p. 1a.

JURISDICTION

The decision of the Sixth Circuit from which petitioners seek a writ of certiorari was filed on April 2, 2010. The Sixth Circuit's Order denying the Petition for Rehearing *En Banc* was filed on June 16, 2010. This Court has jurisdiction pursuant to 28 U.S.C. §1254(1).

The Court of Appeals was vested with jurisdiction over the appeal from the United States District Court pursuant to 28 U.S.C. §1291. The United States District Court was vested with jurisdiction in this case pursuant to 26 U.S.C. §§6511(a), 6532(a), 7402, and 7422, and 28 U.S.C. §1346(a)(1).

STATUTORY AND OTHER PROVISIONS INVOLVED

Pursuant to Supreme Court Rule 14.1(f), the text of the statutory and other provisions involved

in this case is set out in the Appendix beginning at p. 49a. Section 1433, 100 Stat. 2731.

STATEMENT OF THE CASE

On November 17, 1936, Henry H. Timken, Jr. established a Revocable Trust (the Trust) in favor of himself for his life and upon his death for his wife, Louise Blyth Timken. Henry H. Timken, Jr. made various modifications to the Trust over the years with the final one being made by an instrument dated December 29, 1964 (the Trust Agreement). Henry H. Timken, Jr. died on March 15, 1968, at which time the Trust became irrevocable pursuant to its own terms.

Thus, the Trust became irrevocable more than 18 years before the passage of the generation-skipping transfer tax (GST) that has been imposed here. The Trust was even irrevocable 8 years prior to the earlier version of the GST tax which was retroactively revoked in the Tax Reform Act of 1986, P.L. 99-514. The earlier version of the GST tax is set forth in the Tax Reform Act of 1976, P.L. 94-455, but that earlier version did not reach direct skips like those involved here.

In order to qualify for the marital deduction under the federal estate tax, the Trust Agreement provided a marital deduction trust for Louise Blyth Timken, including a general power of appointment so that the entire Trust estate would be payable "in such manner and such proportions, as the donor's said wife [Louise Blyth Timken] may appoint by her Last Will and Testament." The Trust Agreement provided a very specific and detailed

plan of distribution of income and assets from the Trust in the event that Louise Blyth Timken was to die intestate or without exercising the general power of appointment that had been included to meet the requirements for a marital deduction trust.

The terms of the Trust Agreement that provided for the disposition of the Trust assets in the event that the general power of appointment was not exercised upon Louise's death were as follows: the principal divided equally so that one part would be for the benefit of the children of John M. Timken and the second part would be for the benefit of the children of W. R. Timken. John M. Timken and W. R. Timken were the brothers of Henry H. Timken, Jr. Henry H. Timken, Jr. and Louise Blyth Timken did not have any children of their own. Each part of the Trust was to be divided into as many parts as children, then living, and held as individual trusts for said children until they reached the age of 40. In the event that a child was deceased, that child's share would transfer to his/her children in equal parts.

Louise Blyth Timken died on October 3, 1998. Pursuant to her Will, Louise Blyth Timken exercised the general power of appointment only to the extent of directing that the death taxes attributable to the inclusion of the Trust property in her gross estate be paid from the Trust property. She did not otherwise exercise the general power of appointment.

All children of W. R. Timken and John M. Timken were 40 or older at the death of Louise

Blyth Timken and were entitled to receive their entire balance outside of any Trust. Two of the three children of W. R. Timken received their interest under the terms of the Trust Agreement as soon as practicable following the death of Louise Blyth Timken. The third child of W. R. Timken is Edith M. Timken, and she did not receive any interest in the Trust because she made a qualified disclaimer of any interest in the Trust. Accordingly, in accordance with the Trust Agreement, that share of the Trust was subdivided equally and placed into separate new trusts for her three children: Alexander C. Timken, Peter T. Toot, and Elizabeth Burnham Timken, who were all under the age of 40 at that time.

Each of the three children of John M. Timken made a qualified disclaimer as to any interest in the Trust and they did not receive any interest in the Trust. In accordance with the terms of the Trust Agreement, a trust was created for each child of the children of John M. Timken and the assets were distributed equally into those trusts.

Each one of the nine trusts created by these actions applied for and obtained their own taxpayer identification numbers in 1998. Each one of the nine trusts created by these actions have prepared their own federal income tax returns and paid their own taxes on income due thereon since the date of Louise Blyth Timken's death.

No corpus was added to the Trust after September 25, 1985.

Because of the general power of appointment over the Trust property, the Estate of Louise Blyth Timken included the entire value of all of the assets contained in the Trust at the time of Louise Blyth Timken's death in her taxable estate in accordance with Internal Revenue Code §2041. The total amount of estate tax paid by the Estate of Louise Blyth Timken when it filed its federal estate tax return was $33,600,952.67. The amount of the estate tax attributable to the Trust assets was $15,313,793.80 and was paid from the Trust.

Included with the federal estate tax return (IRS Form 706) filed on June 30, 1999, was a Generation-Skipping Transfer Tax voucher (IRS Schedule R-1) which reported that a Generation-Skipping Transfer (GST) tax of $4,077,252.80 was due and owing to the IRS as a result of the actions described above. The computation and payment of the GST was made in compliance with and because of the IRS instructions related to the GST tax.

Each Petitioner timely filed a claim for refund (IRS Form 843) of the GST tax paid described herein. Each claim for refund was denied. The Petitioners timely commenced this lawsuit in the U.S. District Court for the Northern District of Ohio, seeking a refund of Generation-Skipping Transfer Tax (GST) in the amount of $4,077,252.80 plus statutory interest. The Petitioners claimed in the lawsuit that the transfers made from the original marital deduction trust to the new trusts were not subject to the GST tax because they qualify for the exemption from the GST tax provided by the grandfather clause set forth in § 1433(b)(2)(A) of the Tax Reform Act of

1986, Pub.L. 99-514 (the grandfather clause). This is because the two requirements of the grandfather clause were met: (1) the original trust is a Pre-September 25, 1985, Irrevocable Trust and (2) there were not additions to the corpus of the Trust made after September 25, 1985. Respondent United States of America (Respondent) filed its answer denying any liability to the Petitioners.

The parties agreed that there were no genuine issues of material fact, agreed upon the filing of a joint stipulation of facts, and agreed to submit the case to the District Court on cross-motions for summary judgment.

While the cross-motions for summary judgment were pending, the U.S. Tax Court issued its multi-opinion split (10-5) decision in the *Estate of Eleanor R. Gerson v. Commissioner of Internal Revenue*, 127 T.C. No. 11 (2006) (*Gerson*). The decision resulted in six different opinions: the majority opinion, three concurring opinions, and two dissenting opinions, with one judge concurring in the result only. Only seven of the fifteen judges participating in the case joined in the court's Opinion, holding that Treas. Reg. §26.2601-1(b)(1)(i) is a "reasonable and valid interpretation" of Section 1433(b)(2)(A) of the Tax Reform Act of 1986, Pub.L. 99-514. The five dissenting judges concluded that the regulation was contrary to the "plain and unambiguous" language of the statute.

Because there was a deep division within the Tax Court concerning some of the same issues in this case and knowing that the *Gerson* case would be appealed to the Sixth Circuit and possibly

beyond, the District Court decided to await the final outcome of the *Gerson* case before making its decision in this case with the encouragement of the parties.

On November 9, 2007, a three judge panel of the Sixth Circuit (Cole and Cook, Circuit Judges: and Frost, District Judge) issues its opinion in *Gerson*, 507 F.3d 435, sustaining the Respondent's position on the grandfather clause and the Treasury Regulation in effect with respect to that taxpayer. *En banc* review was not sought in *Gerson*. The Petition for Writ of Certiorari in *Gerson* was denied by the U.S. Supreme Court on May 27, 2008, 128 S.Ct. 2502 (2008).

After supplemental memoranda discussing the impact of *Gerson* were submitted by the parties, the District Court in this case issued its opinion in favor of the Respondent and against the taxpayers in March 2009. This decision was timely appealed to the Sixth Circuit.

On April 2, 2010, the Sixth Circuit affirmed the District Court's opinion largely based upon the prior opinion of the Sixth Circuit in the *Gerson* case. The essential holding of the *Gerson* case, which was reaffirmed in this case, is that the grandfather clause is ambiguous and, as a result, the Treasury Regulation promulgated concerning the grandfather clause was entitled to deference and considered reasonable. The Sixth Circuit in this case extended the reasoning of *Gerson* to apply to the older constructive additions regulation in issue here finding the regulation to be both

reasonable and applicable to the taxpayers' situation.

ARGUMENT

I. Summary Of Argument.

The Petition for a Writ of Certiorari should be granted for the following reasons. First, the Sixth Circuit's decision below exacerbates a conflict which exists in the Circuits on the grandfather clause of the GST tax. A taxpayer is exempt from the GST tax in the Eighth and Ninth Circuits but loses in the Second and Sixth Circuits. This creates disparate treatment for similarly situated taxpayers where there should and must be uniformity. Second, the Treasury Department cannot be allowed to overrule Congressional legislation by regulatory fiat; the regulation in issue usurps the role of Congress in determining what to tax. Third, there has been a failure by the Sixth Circuit below to follow the appropriate decisional rules for statutory interpretation established by the Court, which failure warrants the attention of this Court. Fourth, the case presents a very important threshold issue concerning the applicability of the GST tax, which is a tax that has not been previously addressed by the Court. Finally, this case presents a good opportunity for the Court to extend the analytical process in *Chevron* to provide specific guidance to courts and practitioners in determining what language and words are or are not ambiguous so that the Tax Court, District Courts, and Circuit Courts can consistently apply the test and come to similar results instead of the disparate results that

clearly exist at present in this particular area of taxation. Any one of these arguments by itself is sufficient grounds for granting the Petition. Together these arguments create an overwhelming and compelling case for granting the Petition and accepting the case for a hearing on the merits.

II. The Circuit Conflict On The Fundamental Issue Involved Here Creates An Intolerable Situation That Can Only Be Corrected By The Court.

There is absolutely no dispute that a conflict presently exist in the Circuits on the fundamental issue raised in this case which is whether or not the grandfather clause is a plain and unambiguous statute or an ambiguous statute. If a taxpayer is fortunate enough to be in the Eighth or the Ninth Circuits, then they will win because those Courts have determined that statute to be plain and unambiguous, providing for an exemption from the GST tax. But if the taxpayer is unfortunate enough to be in the Second or the Sixth Circuits, they will probably lose because those Circuits have found the statute to be ambiguous. Compare *Simpson v. United States*, 183 F.3d 812 (8th Cir. 1999), and *Bachler v. United States*, 281 F.3d 1078 (9th Cir. 2002), with *Estate of Eleanor R. Gerson v. Commissioner*, 507 F.3d 435 (6th Cir. 2007), *E. Norman Peterson Marital Trust v. Commissioner*, 78 F.3d 795 (2nd Cir. 1996), and this case. No one knows how the other Circuits would rule on the issue.

The Sixth Circuit in its opinion below and in its prior decision in *Gerson* explicitly discussed and recognized the conflicts in the Circuits which exist,

but decided that they are "not bound by the Eighth and Ninth Circuits." As the *Gerson* panel succinctly put it:

> The parties dispute on this second clause brings to this court a question that divides three of our sister circuits and the Tax Court below. Citations omitted. *Gerson*, *supra* at 438.

Clearly, a division presently exists where there should and must be uniformity in taxation.

An examination of the key cases will reveal that the critical distinction between viewing the statute as plain and unambiguous or viewing it as ambiguous leads to a diametrically different result.

In *Simpson v. United Sates*, 183 F.3d 812 (8th Cir. 1999) (*Simpson*), the court held that the plain language of the grandfather clause covers the transfer made by the widow of the grantor in exercising her power of appointment in favor of her 8 living grandchildren. Because the power of appointment was contained in a trust which was irrevocable on September 25, 1985, the action taken by the widow avoided the GST tax pursuant to the grandfather clause. It did not matter to the Eighth Circuit whether the widow had the option to avoid the GST tax by appointing the property to someone other than a skip generation. The only thing that mattered was that the trust containing the general power of appointment was irrevocable on September 25, 1985, which meant that it qualified for the exemption for tax provided by the grandfather clause. Clearly, the court determined

that the power of appointment that made generation-skipping transfer possible was created by the trust and therefore fell outside the reach of the GST tax pursuant to the grandfather clause.

The approach taken by the Eighth Circuit in *Simpson* was wholeheartedly adopted and implemented by the Ninth Circuit in *Bachler v. United States*, 281 F.3d 1078 (9th Cir. 2002). Like the *Simpson* case, the widow in *Bachler* exercised her general power of appointment granted to her in the marital deduction trust created by her husband's will to have some of the money allocated in equal shares to her 6 grandchildren. The Ninth Circuit said that the fact that she exercised the general power of appointment that she possessed under her husband's will exactly meets the description of a transfer exempted from the GST tax by the grandfather clause. It did not matter that the widow could have avoided the GST tax by appointing the property to someone other than a skip generation such as her grandchildren. Because the transfer was made under a trust that was irrevocable prior to September 25, 1985, it clearly qualified for relief under the grandfather clause. There was no need to look at any Treasury Regulations to make the decision in either the *Simpson* or *Bachler* case because the statute clearly exempted the generation-skipping transfer in issue in those cases by its own plain terms.

The approach taken by the Eighth and Ninth Circuits in *Simpson* and *Bachler* respectively stands in stark contrast to the approaches taken by the Second Circuit and Sixth Circuit in *E. Norman Peterson Marital Trust v. Commissioner*, 78 F.3d

795 (2nd Cir. 1996), *Gerson*, and this case. In all of those anti-taxpayer decisions, the two circuit courts found the grandfather clause to be ambiguous permitting the unbelievably strained application of Treasury Regulations promulgated in an attempt to disembowel the clear and plain meaning of the grandfather clause. As a result, the taxpayers lost all of those cases. Thus, it is clear that the determination as to whether the statute is clear and unambiguous instead of ambiguous makes all the difference in the ultimate outcome of this kind of case and all other cases of a similar nature.

Allowing the circuit conflict to stand will subject taxpayers throughout the country to uncertainty caused by differing rules and levels of taxation based solely upon their geographic location. The Respondent has seized upon that very reason as grounds to obtain the Court's review in other tax cases and it is disingenuous for it to argue that those reasons should not apply here just because it was fortuitous enough to win in the lower courts in this case. The government victory here in the courts below does not make the fundamental problem of circuit conflict go away.

Furthermore, the deep division within the United States Tax Court as evidenced by the multiple dissenting and concurring opinions on the precise fundamental issue presented by this case is a further indication of the seriousness of the conflict and that the issues presented here can be considered close, interesting, and challenging questions worthy of the Court's review under Rule 10(a) of the Supreme Court Rules. The issues raised by these cases have also drawn fairly

substantial scholarly attention. See, for example, Richard Nenno, Esq., *Gerson v. Com.: Donees of General Powers of Appointment Over Grandfather Trusts Unite* in 32 TAX MGT. EST., GIFT TR. J., 131 (2007) ("Nenno article").

III. Permitting The Constructive Additions Regulation To Stand Effectively Permits The Treasury Department To Take Away A Benefit Explicitly Conferred By Congress In The Grandfather Clause.

We must start with the basic premise that the Court has repeatedly stated that an income tax regulation cannot take away a benefit conferred by the Internal Revenue Code and that the Treasury Department cannot add a restriction to the statute which is not contained in the statute. Any Treasury Regulation must fail or be held invalid if it takes away a benefit explicitly conferred by Congress and/or imposes a restriction to a taxing statute which is not contained in the statute. *United States v. Calamaro*, 354 U.S. 351, 354 (1957) ("We cannot but regard this Treasury Regulation as no more than an attempted addition to the statute of something which is not there.") The Treasury Department cannot impose a tax by regulation, which is exactly what is happening with the regulation in issue here. See also *Commissioner v. Acker*, 361 U.S. 87 (1959); *Koshland v. Helvering*, 298 U.S. 441, 447 (1936) ("Where a statute is unambiguous, and its directions specific, there is no power to amend it by regulation."); and *United States v. Cartwright*, 411 U.S. 546 (1973) (invalidating Treasury Regulation concerning valuation of mutual fund shares).

At the same time that the present version of GST was enacted, Congress also generously provided for the grandfather clause that provided that any generation-skipping transfer under a trust which was irrevocable on September 25, 1985, (like this one) would not be subject to the tax, but only to the extent that such transfer is not made out of corpus added to the Trust after September 25, 1985. Thus, Congress provided a broad and simple grandfather clause that carves out from the reach of the GST tax various and numerous generation-skipping transfers that would otherwise be subject to the tax. Congress specifically provided that only two statutory requirements had to be met in order to qualify for exclusion from the GST tax under the grandfather clause. One is that the transfer be made under a trust which was irrevocable on September 25, 1985. The second is that the transfer in question not be made out of corpus added to the trust after September 25, 1985.

In the face of such simplicity, the Treasury Department promulgated a series of ever complex and sweeping regulations that have the net effect of completely overriding the Congressional purpose and preventing the broadly worded grandfather clause from protecting all irrevocable trusts containing a general power of appointment.

The Treasury Department took the simple grandfather clause and added one caveat and condition after another through a series of regulations until nothing can fall outside of the GST taxing scheme, including the transfers which occurred in this case and in other cases. This

interpretation and approach advanced in the regulation finds no support in the statutory text.

The words of the statute are plain words, which should be given their normal meaning. The Court stated in *Burlington N.R.R. v. Oklahoma Tax Commission*, 481 US 454, 461 (1987) (*Burlington*):

> The language of the statute itself must ordinarily be regarded as conclusive...unless exceptional circumstances dictate otherwise. When we find the terms of a statute unambiguous, judicial inquiry is complete.

Here, as in *Burlington*, the statutory language is unambiguous. There is nothing that suggests that a trust containing a general power of appointment should not be excepted under the grandfather clause. Driving even deeper into the regulation, there is nothing to support the constructive addition concept introduced by the Constructive Additions Regulation applied against the Petitioners here. Webster's New International Dictionary of the English Language (3rd Edition 1963) defines the term "add" as to "join or unite so as to increase the number, augment the quantity." Under no common understanding of the word can added be given the construction provided by the Treasury Regulation. In accord, *S.D. Warren Co. v. Maine Bd. of Environmental Protection*, 547 U.S. 370, 381-2 fn. 6 (2006) ("If one takes a ladle of soup from a pot...and pours it back into the pot, one has not 'added' soup or anything else to the pot."), citing *South Fla. Water Management Dist. v. Miccosukee*

Tribe, 541 U.S. 95 (2004). The record shows that there has been no actual addition of anything to the Trust.

Furthermore, the concept of a constructive addition finds no support in the statute. Contrast that with other tax statutes passed by Congress. Congress actually uses the word "constructive" when that concept is intended to apply to a tax statute. See, for example, 26 U.S.C. §§267, 318, 544, 1260, 2056, 2652, 3123, and 4216 where that word is used. Congress ought to be able to reasonably expect that normal language usage applies without having to explain or define every word in a statute.

The Treasury Department had no discretion to impose a tax or increase a taxpayer's tax liability. Treasury, as an agency of the Executive branch, is constrained by the laws passed by Congress, who determines who and what is taxed and what is exempted. Congress, not Treasury, made a policy decision when it enacted the 1986 Tax Reform Act to not impose the GST tax on irrevocable trusts already in existence like the one in this case. Treasury, as shown by its anti-taxpayer regulation writing and rewriting, obviously does not like that decision. But it was Congress' decision to make. It should not matter that Treasury really wants to hammer the trust assets and beneficiaries with a GST tax in addition to the confiscatory-like federal estate tax to which they were already subjected by our Internal Revenue Code §2041. The regulation is nothing more than an attempt to amend the tax code to achieve a harsh result, where Congress specifically

expressed its intent to avoid harsh consequences like this one in plain language.

Unable to tax under the plain language of the statute, the Treasury Department attempts to circumvent the statute by promulgating and then citing to its own make-weight regulations reinterpreting and drastically changing the meaning of the Congressionally created grandfather clause. Under the regulations, it is the existence and exercise or lapse of a power of appointment never mentioned in the grandfather clause which triggers the GST tax rather than the date the trust became irrevocable as explicitly stated in the statute. Under the Regulation, the existence of a power of appointment becomes the critical determining factor in the application of the GST tax. The Treasury strategy to continually change the regulations reveals its own lack of confidence in its reading of the plain statutory language. Moreover, it is just plain unfair and unlawful for an agency like the Treasury Department to promulgate and invoke a regulation that bears no resemblance to the statutory language to win litigation. In its eagerness to tax, the Treasury Department supplants the role of both Congress and the courts.

The Treasury Regulation makes the grandfather clause a nullity for all general power of appointment marital deduction trusts, which were the most common tools for garden variety marital estate planning prior to 1983 and which remain commonly used devices for many reasons, including tax reasons. See *Nenno* article, *supra* at p. 134: "After all, until 1982, virtually all marital

deduction trusts were established under §2056(b)(5), which *requires* the surviving spouse to have such a power." Emphasis added. None could qualify for relief under the grandfather clause if a general power of appointment exists with respect to the assets. Courts cannot allow a construction of a statute by regulation or otherwise that, in effect, renders it a nullity. *United States v. Larionoff*, 431 U.S. 864, 872 (1977). See also, *Knight v. Commissioner*, 552 U.S. 181, 190 (2008) ("Accepting the Trustee's approach would render part of the statute entirely superfluous, something we are loath to do.") It is simply impermissible to make and promulgate such a regulation. It is perfectly clear that Congress could have withheld the exception from those existing trusts, but it did not, and it did not grant the Treasury Department any discretion to concoct and add a strained and strange meaning to the phrase generation-skipping transfer under a trust and the word added or the phrase corpus added to the trust in order to reach the result the Treasury wants.

Had Congress actually intended that the presence of a power of appointment would cause ineligibility for the grandfather clause exception to the GST tax, its consistent practice would have caused it to create specific language with the provision. The absence of such specific language in the grandfather clause exception, or even a hint of it, is very strong evidence that Congress had no such intent or expectation. For example, Congress could have added the following language to §1433(b)(2)(A): "provided, however, this exception shall not apply to any generation-skipping transfer resulting from a release, exercise, or lapse of a

general appointment after September 25, 1985." Congress did not add such language to the statute. Compare examples of such an approach in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 239 (1989), footnotes 4 and 5. Thus, the Treasury Department had no power or authority to introduce the constructive additions concept into regulations pertaining to the grandfather clause so as to essentially render it a nullity that exempts nothing from the GST tax.

IV. The Constructive Additions Regulation Is Not A Valid Regulation.

There is no dispute that the constructive Additions Regulation relied upon by Respondent here is an interpretive regulation. This is because the authority for the regulation is derived solely from the interpretive authority under Internal Revenue Code §7805(a), which is more "circumscribed." *United States v. 9 Fertilizer Co.*, 455 U.S. 16 (1982). The Court's decision in *Chevron U.S.A., Inc. v. National Resource Defense Council, Inc.*, 467 U.S. 837 (1984) ("*Chevron*"), is generally considered as setting forth the extent to which a court should accord deference to an agency interpretation of a statutory term, including an interpretive regulation promulgated under the Internal Revenue Code §7805(a). *Chevron* held that:

> "when a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has

> directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court has determined that Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as it would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute. *Supra* at 842-3.

When a court is faced with an interpretive regulation promulgated under Internal Revenue Code §7805(a) the interpretation is entitled to less deference than a legislative regulation. *Rowan Cos. v. United States*, 452 U.S. 274, 253 (1981).

The answers to both *Chevron* questions favor Petitioners here.

First, Congress has directly spoken to the precise question in this case with clear language and intent as determined by the Eighth and Ninth Circuits. Congress intended all irrevocable trust to be exempted from the reach of the GST tax provided that the trust was irrevocable prior to September 25, 1985, and nothing was added to the

corpus of the trust thereafter. There was no suggestion that the existence of a general power of appointment would make a difference, or that the release, exercise, or lapse of a general power of appointment would make a difference. There is no mention in words or by implication of any legal fiction about whether an irrevocable trust could contain a general power or not. Either way, such a trust would qualify for the grandfather clause because no such qualification is contained within the grandfather clause. The grandfather clause was broadly drawn and carries none of the baggage the IRS would like to engraft upon the law. Because the broad language used by Congress is clear and unambiguous, there is no basis to validate the regulation under *Chevron*.

Second the regulation is not a reasonable construction of the grandfather clause. In determining whether an interpretive regulation implements the Congressional mandate in some reasonable manner, the Court should look to see whether the regulation is harmonious with the plain language of the statute, its origin and purpose. In undertaking this analysis the statutory language is paramount. It is clear that Congress intended to generally exempt from the reach of the then-new GST tax all pre-existing irrevocable trusts. The reason is plain: because the grantors could do nothing to change or avoid the impact of the GST tax because their trust were irrevocable. In Mr. Timken's case the Trust had been irrevocable for 18 years prior to the passage of the GST tax in issue here. By definition, the essence of an irrevocable trust is that no changes could be made to take account of future events such

as the passage of a tax act. In order to limit the harsh impact of the GST tax upon such a trust, Congress provided the general exception of the grandfather clause.

Respondent in its regulation would remove from the protection of the grandfather clause and any trust subject to a general power of appointment, even if the trust was irrevocable on September 25, 1985, and no addition had been made to the corpus after that date. Taking this position, Respondent has added major restrictions to the grandfather clause which Congress did not impose. These added restrictions are an unreasonable statutory interpretation which do not harmonize with the plain language of the statute, its origin and its purpose. Regulations can carryout the purposes of an act, not amend it. *Miller v. United States*, 294 U.S. 435, 438 (1935). Accordingly, the constructive additions regulation is invalid, and the grandfather clause excepts the transfers at issue here from the GST tax.

The fact that Mr. Timken gave Mrs. Timken a general power of appointment makes no difference. He obviously gave her the power in order to qualify his Trust for the estate tax marital deduction which then was very conventional estate planning. See *Nenno* article, p. 134. Based on the transfer tax laws in effect in 1968, Mr. Timken knew that the general power of appointment given to his wife would cause the property in the Trust to be included in her estate for federal estate tax purposes. Her estate paid this tax. There was no GST Tax in 1968, however, and thus Mr. Timken also knew that, *regardless of whether or how Mrs.*

Timken exercised the power of appointment, there would be no additional tax (such as the GST Tax) on the property in the Trust. That was the state of the law for the next 18 years until 1986 when the GST tax on direct skips was adopted for the first time as part of the 1986 Act. Under the new GST laws, if it were not for the grandfathering protection under §1433(b)(2)(A) of the 1986 Act, Mrs. Timken's exercise or lapse of the general power of appointment in favor of skip persons would be subject to the new GST tax. In 1986, however, it was obviously too late for Mr. Timken, who had relied on the tax laws in effect up until 1968 when he died, to limit the scope of his wife's power of appointment or otherwise amend the provisions of his Trust so as to protect the transfer of the Trust property from the GST Tax. Mr. Timken was dead. In this situation, the just result - and the result that protects Mr. Timken's reliance interest - is to apply the grandfathering provision under §1433(b)(2)(A) so as to protect the transfer of the Trust property from the GST tax. Any other result would be contrary to the clear purpose of the grandfathering provision provided by Congress in the 1986 Act. Congress did not write the broad grandfather clause unmindful of the norm for marital deduction trusts.

V. The Constructive Additions Regulation Does Not Take The Taxpayers Outside Of The Protection Of The Grandfather Clause.

As argued by Respondent and agreed to by the lower courts, the only place in the applicable Treasury Regulations that could possibly justify the exclusion of the taxpayers from the protection of

the grandfather clause given the facts that exist here is the constructive additions regulation which is found at Treasury Regulations §26.2601-1(b)(1)(v). The claimed operative sentence from that section reads as follows:

> (v) Constructive additions. – (A) *Powers of Appointment.* – Except as provided in paragraph (b)(1)(v)(B) of this section, where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

(hereafter referred to as "the constructive additions regulation"). Assuming this regulation is valid (which it is not as shown in part IV), it does not disqualify the Petitioners from the protection of the grandfather clause.

There are two requirements in the constructive additions regulation which must be present in order to remove a taxpayer from the protection of the grandfather clause. The first is that it only applies to any portion of a trust that

"*remains in the trust*...after the release, exercise, or lapse of a power of appointment." (Emphasis added.) The second concerns whether the "release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12." Neither of those requirements is met here in the case of the taxpayers. If either one of those requirements is missing, then the constructive additions regulation does not apply so as to deny the protection otherwise offered by the broad and clear language of the grandfather clause.

The undisputed evidence in this case shows that no portion of the Trust assets "remains in the trust" after the lapse of the power of appointment. Pursuant to the terms of the irrevocable trust instrument itself, new trusts were established for the children of the children of John M. Timken and W. R. Timken. All trust assets went to those newly-created trusts except for that portion of the trust assets which were used to pay taxes. Thus, when the dust settled, no portion of the Trust "remains in the trust". It was all gone to either pay taxes or fund the new trusts created by operation of the irrevocable trust instrument. Thus, the constructive additions regulation, whether valid or not, did not apply so as to carve out the particular transfers that occurred here from the protection of the grandfather clause.

The second requirement of the constructive additions regulation which is also not met here focuses on whether the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12. Of course, it is not. There is nothing in chapter 11 or chapter 12 that

makes a release, exercise, or lapse at or after death a taxable transfer. What makes the assets in the trust taxable to the powerholder's estate under the estate tax scheme is the very existence of the general power of appointment at the time of death, not its use or any failure to use it. See 26 U.S.C. §2041(b). It does not matter whether it was released, exercised, or lapsed; it only matters that it existed and was possessed at the point of the holder's death. *Estate of James C. Freeman v. Commissioner*, 67 T.C. 202 (1976). Because the second requirement for the applicability of the constructive additions regulation is not met, the regulation does not work against the taxpayers here.

VI. The Case Presents A Very Important Issue For The Administration Of The Generation-Skipping Transfer Tax And The Court Has Not Previously Addressed The GST Tax.

Because there have been five recent cases that have raised this issue which goes to the fundamental question about whether the GST tax applies, conflicts in the Circuits have resulted, and the cases typically involve very large dollar amounts and important questions of estate and trust administration, it is critical that the issue here be resolved. In addition, we would point out that the Court has not previously entered the area of GST taxation and that perhaps this case may be a good vehicle for making a statement about what is subject to the tax and what is exempt from the tax.

VII. The Lower Courts Need The Court's Guidance To Determine When A Statute Is Plain And Unambiguous And When It Is To Be Considered Ambiguous.

This case presents a perfect illustration of how the lower courts are in need of guidance from the Court to determine when a statute should be considered plain and unambiguous and when it should be considered ambiguous. On the one hand, the Eighth and Ninth Circuits looked at the grandfather clause and held it to be plain and unambiguous, providing an exemption to the GST tax. On the other hand, the Second and Sixth Circuits looked at the same grandfather clause and said the exact opposite. This same circuit conflict is further illustrated in the six different opinions authored by the Tax Court judges in the *Gerson* case. Surely, where reasonable and experienced judges can look at the same statutory language and come out so differently, this situation cries out for guidance from the highest court in the land so that when such decisions are made they are made using an appropriate template for decision making.

This case is a perfect opportunity to provide that guidance. The pertinent statutory provisions do not involve science or technology. The applicable portion of the statute is short and is not complicated. Other provisions of the statute impose the GST tax unless the grandfather clause applies. Clearly, the purpose of the grandfather clause was to exempt some generation-skipping transfers from the GST tax. The grandfather clause set out the applicable criteria. The simple and straight-forward statutory criteria were fully

satisfied in this case. Nevertheless, the Regulation withholds the benefit of the grandfather clause and imposes the GST tax that the grandfather clause was designed to prevent. The Regulation and the result look to be at total odds to the grandfather clause. The added requirement in the Regulation that there be no general power of appointment involved amounts to creating a concept-changing exception to the exception that is inconsistent with the grandfather clause itself. Are we to conclude that the grandfather cause would not have been ambiguous if it had gone on to say: "and furthermore, the presence of a general power of appointment in a trust document shall not prevent this exception from being effective?" Would that Congress be so prescient. As it is, we can think of no situations where an old pre-existing marital deduction trust can qualify for the exception. So for all practical purposes, for the time being, Treasury has trumped the Congress, at least in some parts of the country. The lower courts really need better guidance regarding what is (or is not) plain and unambiguous legislation. It can only come from the Court.

CONCLUSION

For all the foregoing reasons, the Petitioners respectfully request that the Court grant the Petition for Writ of Certiorari.

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APPENDIX

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APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 09-3650

[Filed April 2, 2010]

ESTATE OF LOUISE BLYTH TIMKEN, (Deceased), et al., *Plaintiffs-Appellants,*	)
v.	)
UNITED STATES OF AMERICA, *Defendant-Appellee.*	)

Appeal from the United States District Court for the Northern District of Ohio at Akron. No. 04-01188—John R. Adams, District Judge.

Argued: March 4, 2010

Decided and Filed: April 2, 2010

Before: SILER and ROGERS, Circuit Judges; BELL, District Judge.*

* The Honorable Robert Holmes Bell, United States District Judge for the Western District of Michigan, sitting by designation.

COUNSEL

ARGUED: Matthew Yackshaw, DAY KETTERER LTD., Canton, Ohio, for Appellants. Joan I. Oppenheimer, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee. **ON BRIEF:** Matthew Yackshaw, DAY KETTERER LTD., Canton, Ohio, for Appellants. Joan I. Oppenheimer, Richard Farber, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee.

OPINION

ROGERS, Circuit Judge. The Estate of Louise Blyth Timken appeals the district court's decision on cross-motions for summary judgment that transfers from a Timken Estate trust do not fall within the statutory grandfathering exemption to the generation-skipping transfer tax (GST tax). The district court correctly held, however, that the grandfathering exemption is ambiguous as applied to this case, that the regulation at issue is a reasonable interpretation of the statute, and that the transfers at issue fall within that regulation. Therefore, the district court properly upheld the imposition of the GST tax.

I. The grandfathering exemption to the GST tax

This case involves whether the incidence of the estate tax can skip a generation when a pre-GST-tax irrevocable trust does not mandate a generation-skipping transfer but merely grants discretion, exercisable after the GST tax was passed, to the trustee or others to skip generations in transferring trust assets. The GST tax, codified at I.R.C. § 2601, *et seq.*, was enacted in 1976 and amended in 1986. The

tax was intended "to ensure taxation of generation skipping transfers in a comparable manner to outright transfers from one generation to the next, and to remove the estate planning tool of escaping taxation by skipping a generation in an estate transfer." *Comerica Bank, N.A. v. United States*, 93 F.3d 225, 228 (6th Cir. 1996). However, "[t]o protect taxpayers who had legitimately made trust and estate dispositions which, although sensible when made, had become very disadvantageous, and from which they could no longer escape," *E. Norman Peterson Marital Trust v. Comm'r*, 78 F.3d 795, 798 (2d Cir. 1996), the statute includes a grandfathering clause that exempts from the tax, in some circumstances, generation-skipping transfers from trusts that were irrevocable before the GST tax's effective date.

Under this statutory grandfathering exemption, the GST tax does not apply to "any generation-skipping transfer under a trust which was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985." Tax Reform Act of 1986 § 1433(b)(2)(A), codified at I.R.C. § 2601, Effective and Applicability Provisions. This language does not explicitly say whether the grandfathering exemption applies to an irrevocable trust which does not mandate a generation skip, but instead permits a beneficiary by discretionary power of appointment to make a generation-skipping transfer. The Treasury Department promulgated regulations to address this question, including the regulatory provision at issue here, the constructive additions provision, which provides:

> Constructive additions – (A) Powers of Appointment . . . [W]here any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 [of the Internal Revenue Code, on estate taxes] or chapter 12 [of the I.R.C., on gift taxes], the value of the entire portion of the trust subject to the power that was released, exercised or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise or lapse.

Treas. Reg. § 26.2601-1(b)(1)(v)(A) (1998). This regulation permits application of the GST tax to post-statute exercises and lapses of a general power of appointment, thus treating a general power of appointment the same as outright ownership, consistent with treatment of general powers of appointment in other tax code provisions.

II. The generation-skipping transfers in the Timken Estate trust

The Timken Estate trust became irrevocable in 1968, before the passage of the GST tax, with the death of the settlor, Henry H. Timken, Jr. The trust granted Louise Blyth Timken, the settlor's widow, a general power of appointment over the trust assets, and provided that, if that power lapsed, trust assets would be used to pay the estate tax portion due to the inclusion of the trust in her estate, and the remaining trust assets would be divided and placed in separate trusts for Henry H. Timken, Jr.'s nieces and nephews

and for the children of any deceased niece or nephew. Louise Blyth Timken died in 1998 without appointing new trust successors. Therefore, her general power of appointment lapsed and the remaining trust assets passed to Henry H. Timken, Jr.'s nieces and nephews. Some nieces and nephews made qualified disclaimers of their shares, and these shares were divided equally among their children, Henry H. Timken, Jr.'s grandnieces and grandnephews. After receiving IRS notice that it owed over $4 million in GST taxes, the Estate paid the tax and sued to contest liability.

III. The district court's ruling

In the district court, the parties stipulated to the relevant facts and agreed that the Estate must pay the GST tax unless those facts fell within grandfathering exemption. The district court delayed ruling on the parties' cross motions for summary judgment until this court decided *Estate of Gerson v. Commissioner*, 507 F.3d 435 (6th Cir. 2007). This court in *Gerson* held that the grandfathering exemption was ambiguous as applied to a generation-skipping transfer resulting from the *exercise* of a general power of appointment granted in a pre-GST-tax irrevocable trust, and that a 1999 regulatory provision similar to the constructive additions provision was reasonable under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *Gerson*, 507 F.3d at 439-41.

The regulatory provision at issue in *Gerson* did not by its terms apply to the Timken Estate because that provision was part of a 1999 regulatory amendment that, under Treas. Reg. § 26.201-1(c), took effect after Louise Blyth Timken's death in 1998. *Estate of Timken v. United States*, 630 F. Supp. 2d 823, 832-33 (N.D.

Ohio 2009). The district court held, however, that *Gerson* required the conclusion that the grandfathering exemption is ambiguous and applied the *Chevron* framework to the earlier regulatory provision at issue in this case, the constructive additions provision. *Id.* at 830 n.10, 833. The district court held that the constructive additions provision was also reasonable under *Chevron* because it harmonized with the statute's plain language, and the district court concluded that the facts of the present case fell within the constructive additions provision. *Id.* at 833-34. Therefore, the district court held, the lapse of Louise Blyth Timken's general power of appointment was a post-GST-tax constructive addition to the trust and the transfers at issue fell outside the grandfathering exemption to the GST tax. *Id.*

IV. The GST tax applies to this case

The transfers at issue are subject to the GST tax because the grandfathering exemption is ambiguous as applied to this case, the regulation is a reasonable interpretation of the grandfathering exemption, and this case falls within the regulation. The parties agree that the GST tax applies to the transfers to the settlor's grandnieces and grandnephews unless these transfers fall within the grandfathering exemption to the tax. The parties also agree that the *Chevron* framework applies to the constructive additions regulation.

Under *Chevron*, the court first determines whether "Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed

intent of Congress." 467 U.S. at 842-43. "In making the threshold determination under *Chevron*, a reviewing court should not confine itself to examining a particular statutory provision in isolation. Rather, the meaning—or ambiguity—of certain words or phrases may only become evident when placed in context." *Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 666 (2007) (internal quotation marks omitted) (internal citation omitted). When the statute at issue is unclear or does not speak to the precise question at issue, "the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Chevron*, 467 U.S. at 843.

A. The grandfathering exemption is ambiguous as applied to this case

First, as the Estate concedes, we are bound by *Gerson* to conclude that the grandfathering exemption is ambiguous. In *Gerson* we held that the grandfathering exemption was ambiguous as applied to the post-GST-tax exercise of a general power of appointment granted in a pre-GST-tax irrevocable trust. 507 F.3d at 440-41. We reasoned that the language in the statute, "generation-skipping transfer under a trust which was irrevocable," was ambiguous as to whether it included exercises of a general power of appointment under an irrevocable trust:

> The ambiguity of this term ["under"]—a common word without further definition in the GST scheme—results from the conflict between the Estate's reading that "under" merely implies that the trust instrument is the root of the skip power and the Commissioner's reading that the transfer was not under a trust irrevocable

> before 1985, but under [the] will [of the holder of the general power of appointment]. We disagree with the Estate that the statute has a plain meaning, as both parties offer plausible, contrary interpretations.

Id. at 441.

Our analysis relied on the determination that the statutory language was equally ambiguous with regard to lapses and exercises of general powers of appointment. The taxpaying estate in *Gerson* had relied upon cases from other circuits, *Bachler v. United States*, 281 F.3d 1078 (9th Cir. 2002), and *Simpson v. United States*, 183 F.3d 812 (8th Cir. 1999). Those cases had held the grandfathering clause to be unambiguous with respect to *exercises* of general powers of appointment in part by distinguishing a Second Circuit case, *E. Norman Peterson Marital Trust v. Commissioner*, 78 F.3d 795 (2d Cir. 1996). *Bachler*, 281 F.3d at 1080; *Simpson*, 183 F.3d at 814-16. *Peterson* held that the language in the grandfathering exemption "corpus added to the trust" was ambiguous in the context of *lapses* of general powers of appointment. 78 F.3d at 800. In the following terms, we followed *Peterson* and rejected the proffered distinction between exercises and lapses of general powers of appointment:

> We agree with the *Simpson* and *Bachler* courts that the [grandfathering exemption] breeds "under" cases and "added" cases, but we disagree that exercise and lapse come to different ends. In the exercise of a power of appointment, two transfers occur. In the first transfer, the appointment power holder becomes

> the owner of the trust assets for tax purposes. *See* I.R.C. § 2041(a)(2) (including assets over which a decedent has a power of appointment in the decedent's taxable estate). In the second transfer, the holder transfers the assets to a skip person. If the second transfer occurs after the GST tax became effective, tax liability ensues. By contrast, in the lapse of a power of appointment, three transfers occur. The creation of the power of appointment again amounts to a first transfer, but because the holder of the power of appointment never uses the power, the assets flow back through the trust as a second transfer, reaching the skip person in the third transfer from the trust. *See* [Treas. Reg.] § 26.2601-1(b)(1)(v)(A) ("[T]he value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse."). If the lapse occurs after 1985, liability results because assets were added to the trust corpus after September 25, 1985, per the second clause of the [grandfathering exemption]. Tax Reform Act of 1986 § 1433(b)(2)(A).

Gerson, 507 F.3d at 440-41. Therefore, because *Gerson*'s holding—that the grandfathering exemption is ambiguous as applied to the post-GST-tax exercise of a general power of appointment granted in a pre-GST-tax trust—relies on the conclusion that the exercise and lapse of a general power of appointment must come to the same end for GST tax purposes, we are bound to conclude that the grandfathering exemption is ambiguous as applied to a post-GST-tax

lapse of a general power of appointment granted in a pre-GST-tax trust.

As noted, the Ninth Circuit in *Bachler* and the Eighth Circuit in *Simpson* have held that the grandfathering exemption unambiguously precludes the GST tax from applying to transfers resulting from the post-GST-tax exercise of a general power of appointment granted in a pre-GST-tax irrevocable trust. *Bachler*, 281 F.3d at 1080; *Simpson*, 183 F.3d at 814. However, as *Gerson* stated, these cases were decided while the Treasury Department was developing regulations, and "we are surely not bound by the Eighth and Ninth Circuits." 507 F.3d at 440 n.2. This panel is, moreover, bound by *Gerson*, which reached a conclusion different from the one reached in *Simpson* and *Bachler*.

B. The constructive additions regulation is reasonable

Gerson also held that a different, later-added regulatory provision, the 1999 regulatory amendment, reasonably resolves the statutory ambiguity in the grandfathering exemption. Because the constructive additions provision resolves the statutory ambiguity in the same way as the 1999 regulatory amendment, the conclusion is inescapable that the constructive additions regulation is also reasonable.

Under the 1999 regulatory amendment at issue in *Gerson*, the grandfathering exemption "does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12." Treas. Reg. § 26.2601-1(b)(1)(i). Under

the relevant part of the constructive additions provision applicable in this case,

> where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse.

Treas. Reg. § 26.2601-1(b)(1)(v)(A) (1998). These two regulatory provisions resolve the ambiguity in the same way—under both provisions, the grandfathering exemption does not apply to a generation-skipping transfer that results from the post-GST-tax release, exercise, or lapse of a general power of appointment when that release, exercise, or lapse is subject to estate or gift taxes. In *Gerson*, we determined that the 1999 regulatory amendment was reasonable because, like other tax code provisions, the 1999 regulatory amendment treats a general power of appointment like outright ownership. 507 F.3d at 441. Because the constructive additions provision reaches the same result as the 1999 regulatory amendment, the constructive additions regulation is also reasonable.[1]

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[1] Even without *Gerson*, the constructive additions regulation is a reasonable interpretation of the statute because it construes the grandfathering exemption to treat a general power of appointment

The Estate argues that the concept of a constructive addition is impermissible and that the term "added" in the grandfathering exemption is limited to additions from an outside source. However, the Treasury Department rejected this narrow definition of "added" because it found that a broad definition that included constructive additions pursuant to a general power of appointment would effect congressional intent that the grandfathering exemption apply "only in those cases where the generation-skipping transfer could not be avoided." Generation-Skipping Transfer Tax Regulations; Effective Date Provisions for Generation-Skipping Transfer Tax, 45 Fed. Reg. 53,123, 53,124 (Aug. 11, 1980); *see also Peterson*, 78 F.3d at 800-01. Therefore, including constructive additions as part of the corpus that may be added to the trust is a reasonable construction of the statute.

The Estate's remaining arguments fail. A settlor's potential reliance on the taxfree status of generation-skipping transfers when he created the trust is immaterial because "[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code." *United States v. Carlton*, 512 U.S. 26, 33 (1994). In this case, the settlor's potential reliance interests are not at issue because these generation-skipping transfers resulted from trust successors' post-

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like outright ownership, as that power is treated in other tax code provisions. Treating the general power of appointment like outright ownership is reasonable because the holder of that power may exercise it to pass the trust corpus to someone other than a person two or more generations below the holder of that power, thereby avoiding the GST tax, or may use all the trust assets to pay personal taxes and debts.

GST-tax qualified disclaimers, not the trust itself. *Ann Jackson Family Foundation v. Commissioner*, 15 F.3d 917, 921-22 (9th Cir. 1994), is inapposite because that case, unlike this one, concerned regulation that was not revised after an amendment significantly narrowed the corresponding statute. Revision of the constructive additions provision after the 1986 amendment to the GST tax was unnecessary because the grandfathering exemption—apart from the GST tax's effective date—remained the same. As the Estate argues, the constructive additions provision probably renders the grandfathering exemption inapplicable every time a pre-GST-tax general power of appointment is exercised post-GST-tax to skip generations. However, that result is neither unfair nor contrary to the purposes of the statute, and in fact that result achieves the GST tax's purpose of taxing generation-skipping transfers in a manner comparable to single-generation transfers. *See Comerica Bank*, 93 F.3d at 228.

C. The constructive additions provision applies to the generation-skipping transfers at issue

The Estate also argues that the constructive additions provision by its technical terms does not in fact apply in this case. The constructive additions provision, however, does apply to the generation-skipping transfers at issue and renders the grandfathering exemption inapplicable, because trust assets remained in the trust after the lapse of Louise Blyth Timken's general power of appointment and that lapse was subject to estate taxes.

A constructive addition occurs when (1) a portion of a trust remains in the trust after the post-September

25, 1985 release, exercise, or lapse of a power of appointment over that portion of the trust, and (2) the release, exercise, or lapse is treated as a taxable transfer in the estate and gift provisions of the tax code. The first requirement is met because trust assets remained in the trust after the payment of Louise Blyth Timken's estate taxes attributable to the inclusion of trust property in her estate. The second requirement is met because, as the parties stipulated, Louise Blyth Timken's estate paid estate taxes "[b]ecause of the general power of appointment over the Trust property." Therefore, the Timken trust assets are "treated as if [they] had been withdrawn and immediately retransferred to the trust at the time of the . . . lapse [of the general power of appointment]," Treas. Reg. § 26.2601-1(b)(1)(v)(A) (1998), and because these transfers occurred after the effective date of the GST tax, the subsequent transfers of trust assets to her grandnieces and grandnephews are subject to the GST tax.

This case resembles Example 1 of the constructive additions provision, and the Estate conceded at oral argument that Example 1 is part of the applicable regulation. Example 1 provides:

> Lapse of a power of appointment. On June 19, 1980, T established an irrevocable trust with a corpus of $500,000. The trust instrument provides that the trustee shall distribute the entire income from the trust annually to T's spouse, S, during S's life. At S's death, the remainder is to be distributed to T and S's grandchild, GC. T also gave S a general power of appointment over one-half of the trust assets. On December 21, 1989, when the value of the

> trust corpus is $1,500,000, S died without having exercised the general power of appointment. The value of onehalf of the trust corpus, $750,000 ($1,500,000 x .5) is included in S's gross estate under section 2041(a) and is subject to tax under Chapter 11. Because the value of one-half of the trust corpus is subject to tax under Chapter 11 with respect to S's estate, S is treated as the transferor of that property for purposes of Chapter 13 [on the GST tax] (see section 2652(a)(1)(A)). For purposes of the generation-skipping transfer tax, the lapse of S's power of appointment is treated as if $750,000 ($1,500,000 x .5) had been distributed to S and then transferred back to the trust. Thus, S is considered to have added $750,000 ($1,500,000 x .5) to the trust at the date of S's death. Because this constructive addition occurred after September 25, 1985, 50 percent of the corpus of the trust became subject to Chapter 13 at S's death.

Treas. Reg. § 26.2601-1(b)(1)(v)(D) (1998). Like the spouse in Example 1, Louise Blyth Timken had a general power of appointment over trust assets, and therefore these assets were included in her gross estate and subject to estate taxes. When Louise Blyth Timken's general power of appointment lapsed, the portion of the trust over which she had a general power of appointment—the entire trust—is treated as if it had been distributed to her, then transferred back to the trust, so that she is considered to have added that portion of the trust assets to the trust after September 25, 1985. Though Example 1 does not explicitly state that the portion of the trust assets over which the spouse had the general power of

appointment "remained" in the trust after the lapse of that power, that conclusion is compelled because Example 1 does state that the portion of the trust over which the spouse had a general power of appointment was subject to the GST tax and, under the regulation, the GST tax only applies to trust assets that remain in the trust following a post-September 25, 1985 lapse of a general power of appointment. Therefore, trust assets that subsequently pass to persons two or more generations below the transferor, such as grandnieces and grandnephews, are subject to the GST tax.

The Estate's attempts to distinguish Example 1 fail. For grandfathering purposes, it is immaterial whether the trust was created before or after the 1986 amendment to the GST tax because the only relevant date for the exemption's application is September 25, 1985. It is also immaterial whether the settlor is alive or dead so long as the trust was irrevocable before September 25, 1985. Though the Estate notes that Example 1 does not provide whether the general power of appointment was granted pursuant to a marital deduction trust, this distinction is immaterial because neither the statute nor the regulation distinguishes a general power of appointment granted pursuant to a marital deduction trust from another general power of appointment. Though the recipients of the generation-skipping transfers in Example 1 are grandchildren rather than grandnieces and grandnephews, this distinction is also immaterial because both transfers are to persons who are two or more generations below the transferor.

V. Conclusion

For the foregoing reasons, the district court's judgment is affirmed.

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 09-3650

[Filed April 2, 2010]

ESTATE OF LOUISE BLYTH TIMKEN, (Deceased), et al., Plaintiffs - Appellants,	)
v.	)
UNITED STATES OF AMERICA, Defendant - Appellee.	)

Before: SILER and ROGERS, Circuit Judges; BELL, District Judge.

JUDGMENT

On Appeal from the United States District Court for the Northern District of Ohio at Akron.

THIS CAUSE was heard on the record from the district court and was argued by counsel.

IN CONSIDERATION WHEREOF, it is ORDERED that the judgment of the district court is AFFIRMED.

ENTERED BY ORDER OF THE COURT

/s/Leonard Green
Leonard Green, Clerk

APPENDIX B

ADAMS, J.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CASE NO. 5:04CV1188

JUDGE JOHN R. ADAMS

[Filed March 25, 2009]

ESTATE OF LOUISE BLYTH TIMKEN (Deceased), et al.,	)
Plaintiffs,	)
v.	)
UNITED STATES OF AMERICA,	)
Defendant.	)

MEMORANDUM OF OPINION AND ORDER
[RESOLVING DOCS. 15 and 16]

In this tax refund case, the plaintiffs[1] seek a refund of over $4 million in generation- skipping transfer ("GST") tax plus statutory interest. Plaintiffs' entitlement to the refund turns on whether Treasury Regulation § 26.2601-1(b)(1)(v)(A), the constructive additions Regulation (the "Regulation"),[2] is valid; and, if the Regulation is valid, whether it applies to the facts in this case. Through their cross-motions for Summary Judgment (Docs. 15 and 16), which are presently before the Court, the parties have fully briefed the issues. The United States of America filed a Brief in Support of its Motion for Summary Judgment (Doc. 17), a Brief in Opposition to plaintiffs' Motion for Summary Judgment (Doc. 20), and a Reply Brief (Doc. 26). Plaintiffs filed a Brief in Opposition to Defendant's Motion for Summary Judgment (Doc. 19), a Reply Brief (Doc. 25), and two Notices of Supplemental Authority (Docs. 27 and 28). The parties also filed a Joint Stipulation of Facts (Doc. 14).

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[1] Plaintiffs are the Estate of Louise Blyth Timken, Henry H. Timken, Jr. Trust Fund A, Henry H. Timken, Jr. Trust, Fund A1A fbo Alexander C. Timken, Henry H. Timken, Jr. Trust, Fund A1B fbo Peter T. Toot, Henry H. Timken, Jr. Trust, Fund A1C fbo Elizabeth Burnham Timken, Henry H. Timken, Jr. Trust, Fund A2A fbo Susan Mead Matthews, Henry H. Timken, Jr. Trust Fund A2B fbo Thomas Wesley Matthews, Henry H. Timken, Jr. Trust, Fund A2C fbo Anna Virginie Corwin Timken, Henry H. Timken, Jr. Trust, Fund A2D fbo Nicholas Timken, Henry H. Timken, Jr. Trust, Fund A2E fbo John Henry Timken, and Henry H. Timken, Jr. Trust, Fund A2F fbo Stuart Morgan Timken (collectively "Plaintiffs").

[2] *See* Treasury Decision 8644, dated December 27, 1995, 60 FR 66898-02, 1995 WL 17001231.

The Court has also considered the supplemental memoranda (Docs. 37 and 38) filed on July 10, 2008, in response to the Court's Order (Doc. 32) that the parties address the decision of the United States Court of Appeals for the Sixth Circuit in *Estate of Gerson v. C.I.R.*, 507 F.3d 435 (6th Cir. 2007), *cert. denied*, *Kleinman v. C.I.R.*, 128 S.Ct. 2502 (2008)[3] and its impact on the issues presented in the case at bar.

The Court has reviewed the motions, memoranda in support and in opposition, the record evidence, and the applicable law. For the reasons set forth herein, the Court holds that the Regulation is valid and applies to the facts in this case and the plaintiffs are not entitled to a tax refund. Thus, plaintiffs' Motion for Summary Judgment (Doc. 15) will be DENIED and defendant's Motion for Summary Judgment (Doc. 16) will be GRANTED.

THE SUMMARY JUDGMENT STANDARD

Summary judgment is appropriately granted when

> . . . the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.

Fed. R. Civ. P. 56(c). *See also Johnson v. Karnes*, 398 F.3d 868, 873 (6th Cir. 2005).

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[3] Plaintiffs filed an *amicus* brief in support of the taxpayer in the Sixth Circuit. Plaintiffs also filed an *amicus* brief in support of the Petition for Writ of Certiorari in the Supreme Court.

The moving party is not required to file affidavits or other similar materials negating a claim on which its opponent bears the burden of proof, so long as the movant relies upon the absence of the essential element in the pleadings, depositions, answers to interrogatories, and admissions on file. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). The moving party must "show that the non-moving party has failed to establish an essential element of his case upon which he would bear the ultimate burden of proof at trial." *Guarino v. Brookfield Tp. Trustees*, 980 F.2d 399, 403 (6th Cir. 1992). Once the movant makes a properly supported motion, the burden shifts to the non-moving party to demonstrate the existence of a genuine dispute. Under Fed. R. Civ. P. 56(e)(2),

> . . . an opposing party may not rely merely on allegations or denials in its own pleading; rather, it's response must – by affidavits or as otherwise provided in this rule – set out specific facts showing a genuine issue for trial.

The non-moving party must, in order to defeat the motion, "show that there is doubt as to the material facts and that the record, taken as a whole, does not lead to a judgment for the movant." *Guarino*, 980 F.2d at 403. In reviewing the motion for summary judgment, the Court must view the evidence in the light most favorable to the non-moving party when deciding whether a genuine issue of material fact exists. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587-88 (1986); *Adickes v. S.H. Kress & Co.*, 398 U.S. 144 (1970); *White v. Turfway Park Racing Ass'n, Inc.*, 909 F.2d 941, 943-44 (6th Cir. 1990).

The United States Supreme Court, in deciding *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986), stated that in order for a motion for summary judgment to be granted, there must be no genuine issue of material fact. *Id.* at 248. A fact is "material" only if its resolution will affect the outcome of the lawsuit. In determining whether a factual issue is "genuine" the Court must decide whether the evidence is such that reasonable jurors could find that the non-moving party is entitled to a verdict. *Id.* To withstand summary judgment, the non-movant must show sufficient evidence to create a genuine issue of material fact. *Klepper v. First Am. Bank*, 916 F.2d 337, 342 (6th Cir. 1990). The existence of a mere scintilla of evidence in support of the non-moving party's position ordinarily will not be sufficient to defeat a motion for summary judgment. *Id.*

THE FACTS

On November 17, 1936, Henry H. Timken, Jr. established a revocable trust in favor of himself for his life and upon his death for his wife, Louise Blyth Timken, under the name "Henry H. Timken, Jr. Trust, Fund A." Doc. 14 at ¶¶1 and 3. At the time of its creation, Henry H. Timken, Jr. transferred assets to the Henry H. Timken, Jr. Trust, Fund A. *Id.* at ¶4. The original Trustee was the Cleveland Trust Company. Subsequent trustees were Ameritrust, Key Bank, N.A. (the trustee at the time of Louise Blyth Timken's death), and finally Mellon Bank, N.A. (the Trustee as of August 15, 2005). *Id.* at ¶5.

Henry H. Timken, Jr. modified the Henry H. Timken, Jr. Trust, Fund A several times before his death on March 15, 1968 – the final modification was

dated December 29, 1964 (hereinafter the Henry H. Timken, Jr. Trust, Fund A, as modified on December 29, 1964, shall be referred to as the "Trust Agreement"). *Id.* at ¶¶6-15; *see also* Doc. 14-6 (Trust Agreement). It is this latter trust that contains the relevant dispositive provisions. The Trust became irrevocable upon the death of Henry H. Timken, Jr. *Id.* at ¶16. According to one of the advisors to the Trust, "no corpus was added" to the Trust after September 25, 1985. Affidavit of Donald R. Black (Doc. 15-3) at ¶4.

In Article I(b)(2) of the Trust Agreement, the Trust gave Louise Blyth Timken a general power of appointment by will in order to qualify the Trust for the estate tax marital deduction under Internal Revenue Code ("I.R.C.") § 2056(b)(5).[4] Doc. 14-6 at 4-5. When she died on October 3, 1998, Louise Blyth Timken had exercised her general power of appointment only to the extent of directing that the federal estate tax attributable to the inclusion of the Trust property in her gross estate be paid from the Trust property. She did not otherwise exercise the general power of appointment. Doc. 14 at ¶19; *see also* Doc. 14-7 (the Last Will and Testament and two codicils of Louise Blyth Timken). Because of her general power of appointment over the Trust property, the Trust property was included in Mrs. Timken's

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[4] Pursuant to 26 U.S.C. § 2514(e), "[t]he lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. . . ." Further, "[t]he . . . release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power." 26 U.S.C. § 2514(b).

gross estate for federal estate tax purposes pursuant to I.R.C. § 2041.[5] The Estate of Louise Blyth Timken paid $33,600,952.67 in federal estate tax. Doc. 15-3 at ¶9. The amount of the federal estate taxes attributable to the inclusion of the Trust assets into the Estate of Louise Blyth Timken totaled $15,313,793.80, which was paid by the Trust. *Id.* at ¶8.

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[5] Section 2041, 26 U.S.C. provides in relevant part:

(a) **In general.** – The value of the gross estate shall include the value of all property.

* * *

(2) Powers created after October 21, 1942. – To the extend of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. For purposes of this paragraph (2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

* * *

(b) **Definitions.** – For purposes of subsection (a) –

(1) General Power of Appointment. – The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that – . . . .

(2) Lapse of power. – The lapse of a power of appointment created after October 21, 1942, during the life of the individual possessing the power shall be considered a release of such power. . . .

Louise Blyth Timken and Henry H. Timken, Jr. did not have any children of their own. Doc. 14, at ¶17. W.R. Timken and John M. Timken were the brothers of Henry H. Timken, Jr. Edith M. Timken, Jane M. Timken, Barbara C. Timken, and John M. Timken, Jr. are the nieces and nephew of Louise Blyth Timken and Henry H. Timken, Jr.

All children of W.R. Timken and John M. Timken were forty years or older at the death of Louise Blyth Timken and were entitled to receive their entire balance outside of any trust. *Id.* at ¶20. Two of the three children of W.R. Timken received their interest under the terms of the Trust Agreement as soon as practicable following the death of Louise Blyth Timken. *Id.* at ¶21. The amounts the two children of W.R. Timken received under the terms of the Trust Agreement are not in any way affected or involved in this lawsuit and they make no claim for refund of any tax related to the distributions which they received under the terms of the Trust Agreement. *Id.* at ¶22.

Edith M. Timken is the third child of W.R. Timken, and she did not receive any interest in the Trust because she made a Qualified Disclaimer of any interest in the Trust. *Id.* at ¶23; *see also* Doc. 14-8 (Edith M. Timken's Qualified Disclaimer). Following Edith M. Timken's Qualified Disclaimer, that share of the Trust was subdivided and placed into trusts pursuant to the terms of the Trust Agreement for her three children: Alexander C. Timken, Peter T. Toot, and Elizabeth Burnham Timken, who were all then under the age of 40. Doc. 14 at ¶25. The trust established for Alexander C. Timken is named "Henry H. Timken, Jr. Trust, Fund A1A fbo Alexander C. Timken" and one-third of the funds otherwise due to

Edith M. Timken were distributed into that trust. *Id.* at ¶26. The trust established for Peter T. Toot is named "Henry H. Timken, Jr. Trust, Fund A1B fbo Peter T. Toot" and one-third of the funds otherwise due to Edith M. Timken were distributed into that trust. *Id.* at ¶27. The trust established for Elizabeth Burnham Timken is named "Henry H. Timken, Jr. Trust, Fund A1C fbo Elizabeth Burnham Timken" and the remaining one-third of the funds otherwise due to Edith M. Timken were distributed into that trust. *Id.* at ¶28.

The children of John M. Timken (Jane M. Timken, Barbara C. Timken, and John M. Timken, Jr.) also did not receive any interest in the Trust because each made a Qualified Disclaimer of any interest in the Trust. *Id.* at ¶¶29 and 30; *see also* Docs. 14-9 through 14-11 (Qualified Disclaimers of Jane M. Timken, Barbara C. Timken, and John M. Timken, Jr.). Following the Qualified Disclaimer made by Jane M. Timken, that share of the Trust otherwise going to her was subdivided equally and placed into two separate trusts for her two children: Susan Mead Matthews and Thomas Wesley Matthews, who were both then under the age of 40. Doc. 14 at ¶¶32 and 33. The trusts established for Susan Mead Matthews and Thomas Wesley Matthews are named the "Henry H. Timken, Jr. Trust, Fund A2A fbo Susan Mead Matthews" and the "Henry H. Timken, Jr. Trust, Fund A2B fbo Thomas Wesley Matthews", respectively. *Id.* at ¶¶34 and 35.

Following Barbara C. Timken's Qualified Disclaimer and pursuant to the terms of the Trust, that share of the Trust was subdivided equally and placed into two separate trusts for her two children

(Anna Virginie Corwin Timken and Nicholas Timken), who were both then under the age of 40. *Id.* at ¶¶37and 38. The trusts established for Anna Virginie Corwin Timken and Nicholas Timken are named the "Henry H. Timken, Jr. Trust, Fund A2C fbo Anna Virginie Corwin Timken" and the "Henry H. Timken, Jr. Trust, Fund A2D fbo Nicholas Timken", respectively. *Id.* at ¶¶39 and 40.

Following the Qualified Disclaimer made by John M. Timken, Jr., that share of the Trust otherwise going to him was subdivided and placed into two equal parts and placed in separate trusts for his two children (John Henry Timken and Stuart Morgan Timken), who were both then under the age of 40. *Id.* at ¶¶42 and 43. The trusts established for John Henry Timken and Stuart Morgan Timken are named the "Henry H. Timken, Jr. Trust, Fund A2E fbo John Henry Timken" and the "Henry H. Timken, Jr. Trust, Fund A2F fbo Stuart Morgan Timken" respectively. *Id.* at ¶¶44 and 45.

On June 30, 1999, the Executors of the Estate of Louise Blyth Timken filed a Federal Estate Tax Return (IRS Form 706) for the Estate of Louise Blyth Timken. *Id.* at ¶46. With IRS Form 706, the Executors filed a GST tax voucher (IRS Schedule R-1) which reported that a GST tax of $4,077,252.80 was due and owing to the IRS as provided for in I.R.C. §§ 2601 - 2664 based on the generation-skipping transfers resulting from the Qualified Disclaimers filed by Edith M. Timken, Jane M. Timken, Barbara C. Timken, and John M. Timken, Jr. *Id.* at ¶48; *see also* Doc. 14-12 (IRS Schedule R-1). The computation and payment of the GST tax was made in compliance with and because

of the IRS instructions related to the GST tax. Doc. 15-3 at ¶10.

With the filing of IRS Schedule R-1, plaintiff Henry H. Timken Jr. Trust, Fund A paid the U.S. Treasury the GST tax in the amount of $4,077,252.80. Doc. 14 at ¶¶50 and 52; *see also* Doc. 14-13 (the check used to pay the GST tax). On June 27, 2002, plaintiff Henry H. Timken Jr. Trust, Fund A filed a Claim for Refund (IRS Form 843) of the $4,077,252.80 GST tax. Doc. 14 at ¶53; *see also* Doc. 14-14 at 3-7 (IRS Form 843 and attachment thereto). The IRS has not paid the claim for refund, and plaintiff Henry H. Timken Jr. Trust, Fund A timely commenced this lawsuit.[6] Doc. 14 at ¶55.

The GST tax is imposed on every GST made after October 22, 1986, the date of enactment of the Tax Reform Act of 1986, Pub.L. No. 99-514, 100 Stat. 2085. A "generation-skipping transfer" is defined by 26 U.S.C. § 2611(a) as "any of three types of transfers: A taxable termination, a taxable distribution, or a direct skip." *E. Norman Peterson Marital Trust v. C.I.R.*, 102 T.C. 790, 793-94 (1994), *aff'd*, 78 F.3d 795, 800 (2d Cir. 1996). "In general, a transfer of an interest in property constitutes a 'direct skip' if: (1) The transfer is subject to either the Federal gift tax or the Federal estate tax;

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[6] The remaining plaintiffs are the Estate of Louise Blyth Timken, deceased, and the nine subtrusts created for the benefit of Alexander C. Timken, Peter T. Toot, Elizabeth Burnham Timken, Susan Mead Matthews, Thomas Wesley Matthews, Anna Virginie Corwin Timken, Nicholas Timken, John Henry Timken, and Stuart Morgan Timken. Plaintiffs are not seeking double recovery by the estate and trusts, although the Complaint (Doc. 1) appears to request such relief.

and (2) the transfer is to a 'skip person.'" *Id.* at 794 (citing 26 U.S.C. § 2612(c)(1)). A "skip person" is a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor or a trust whose interests are held by a skip person. 26 U.S.C. § 2613(a).

As the children of some of the nephews and nieces of Louise Blythe Timken, Alexander C. Timken, Peter T. Toot, Elizabeth Burnham Timken, Susan Mead Matthews, Thomas Wesley Matthews, Anna Virginie Corwin Timken, Nicholas Timken, John Henry Timken, and Stuart Morgan Timken are at least two generations below the generation assignment of Louise Blythe Timken. Further, Louise Blythe Timken's general power of appointment over the marital trust corpus caused the Trust property to be included in her gross estate under section 2041. As such, both requirements of a "direct skip" are satisfied and the transfers of Trust property to the nine subtrusts constitute direct skips. 26 U.S.C. §§ 2651(b)(2) and 2613(a)(2). Indeed, the parties do not dispute that such transfers were "direct skips." *See* Doc. 19 at 6 (stating that the plaintiffs do not dispute that "the transfer of the Trust property in issue here would be subject to the GST tax" absent the grandfather clause of Tax Reform Act of 1986 § 1433(b)(2)(A)[7]).

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[7] Section 1433(b)(2)(A) excepts transfers from the reach of the GST tax. The statute provides that all transfers under a trust which is irrevocable on September 25, 1985, are exempt from the reach of the GST tax. The only exclusion to this broad exception is for corpus added to the trust after September 25, 1985. It states:

> 2) EXCEPTIONS. -- The amendments made by this part shall not apply to -- (A) any generation-skipping transfer *under* a trust which was irrevocable on September 25,

ANALYSIS

Impact of the *Gerson* case on the issues presented

Gerson, *supra*, was decided on November 9, 2007. The decedent in *Gerson* was the lifetime beneficiary of a pre-September 25, 1985 GST trust created by her husband. She was given the right to use the income during her life and to appoint a beneficiary to receive the corpus when she died. To the extent the decedent failed to exercise her power of appointment, the remaining trust assets flowed into a trust for her children's benefit. Decedent's will exercised her power of appointment in favor of her grandchildren. The irrevocable trust document at issue in *Gerson* did not provide for the direct skip to the grantor's or decedent's grandchildren. The Sixth Circuit affirmed the United States Tax Court's split decision to assess a tax on the proceeds of the irrevocable trust under the GST tax because the Commissioner's regulation reasonably construed an ambiguous statutory provision. 507 F.3d at 436. The Court of Appeals largely adopted the same rationale as did the Tax Court in upholding the validity of Regulation § 26.2601-1(b)(1)(i).[8] Similar to the taxpayer in *Gerson*,

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1985, but only to the extent that such transfer is not made out of corpus *added to the trust* after September 25, 1985. (Emphasis added.)

[8] Final Treasury Regulation § 26.2601-1(b)(1)(i) (applicable on and after November 18, 1999) provides that the grandfather exception "does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated

the plaintiffs in the case at bar concede that the GST tax would ordinarily apply, but cite the effective date provision that grandfathers certain unmodified irrevocable trusts created before 1985. *See* Tax Reform Act of 1986 § 1433(b)(2)(A).

After finding the grandfather clause to be ambiguous as applied, the Sixth Circuit then applied *Chevron*[9] deference to the agency's interpretation of Regulation § 26.2601-1(b)(1)(i) and found the agency offered a reasonable interpretation of the statute. Pursuant to the language of the Regulation applicable to the taxpayer in *Gerson*, the grandfather clause does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment. Because the taxpayer in *Gerson* had exercised a general power of appointment in such a way as to make a direct skip within the meaning of the GST tax, the Sixth Circuit determined that the assessment of the GST tax was appropriate. The Court also explained in conclusion:

> . . . As the *Peterson* court recognized, "For tax purposes, a general power of appointment has for many, many years been viewed as essentially identical to outright ownership of the property." 78 F.3d at 800. Thus, the regulation conforms the grandfather clause to other elements of the tax scheme. *See* I.R.C. § 2041(a)(2) (power of appointment included in

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as a taxable transfer under chapter 11 [estate tax] or chapter 12 [gift tax]."

[9] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

> estate); *id.* § 2514(b) (exercise or release of a general power of appointment incurs gift tax). In addition, the other exceptions to the GST tax surrounding the irrevocable trust provision all represent inescapable contingencies that justify grandfathering, while the Estate's proposed interpretation protects disproportionately broad reliance on prior tax laws. . . .

507 F.3d at 441.

In their Joint Motion for Extension of Time to File Supplemental Memoranda (Doc. 33), filed on December 3, 2007, the parties stated they "believe[d] that the final conclusion of the *Gerson* case may be case determinative of this case." *Id.* at 1. On May 27, 2008, the Supreme Court denied certiorari. *See Kleinman v. C.I.R.*, 128 S.Ct. 2502 (2008). Thereafter, the plaintiffs filed a supplemental memorandum that provides in pertinent part:

> The *Gerson* case does settle certain issues in this case because it is binding precedent. However, *Gerson* does not settle all issues in this case. There is a difference in both the facts and the law between this case and the *Gerson* case, which means that this Court can and should rule in favor of Plaintiffs despite the holding in *Gerson*.

Doc. 38 at 1.

Defendant argues, to the contrary, that "[s]imply put, Gerson is dispositive of this action." Doc. 37 at 1. According to the defendant, "[b]ecause the Gerson court rejected the two arguments made by the

plaintiffs here, that the regulation's interpretation of the statute was unreasonable, and is therefore invalid, and that the analysis in Simpson [v. United States, 183 F.3d 812 (8th Cir.1999)] and Bachler [v. United States, 281 F.3d 1078 (9th Cir. 2002)] should control, Gerson is dispositive of this action . . . ." *Id.* at 3.

Plaintiffs' position after *Gerson*

Plaintiffs contend they qualify for exemption from the GST tax because of the grandfather provision of section 1433(b)(2)(A) of the Tax Reform Act of 1986. Plaintiffs' refund claim is based upon three arguments. First, the transfers from the Trust to the new trusts are not subject to the GST tax because the Trust is a pre-September 25, 1985, irrevocable trust and there were no additions to the corpus of the Trust after September 25, 1985. Therefore, the plaintiffs are entitled to the refund under the plain language of section 1433(b).[10] Second, Regulation § 26.2601-1(b)(1)(v)(A) is not a valid and enforceable regulation. Finally, even if the Regulation is valid, it

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[10] With the understanding that Plaintiffs expressly reserve the right to challenge *Gerson* on appeal, Plaintiffs here must concede that Argument 1 of their Motion for Summary Judgment has either been explicitly or implicitly decided against them in the *Gerson* opinion. Thus, Plaintiffs are conceding that it has been held by the Sixth Circuit that the statutory grandfather clause is ambiguous rather than a plain statute enforceable by its express terms as argued in their Motion for Summary Judgment (Doc. #15, Argument #1).

Doc. 38 at 2-3.

does not apply to the facts in this case.[11] According to the plaintiffs, the distributions to the nine new trusts at issue are not affected by the constructive additions regulation.

Validity of Regulation § 26.2601-1(b)(1)(v)(A)

Defendant contends that the Regulation controls and establishes that the plaintiffs are not entitled to a refund. *See E. Norman Peterson Marital Trust v. Comm'r*, 78 F.3d 795, 800-801 (2d Cir. 1996) (In upholding the validity of section 26.2601-1(b)(1)(v)(A), the Second Circuit concluded that property remaining in the trust after the *lapse* of a general power of appointment was a constructive addition that became subject to GST tax because a general power of appointment is "essentially identical to outright ownership of the property."). According to the defendant, the partial lapse of the general power of appointment in the case at bar constituted a post-September 25, 1985, constructive addition to the corpus of the Trust under the Regulation. The Regulation at issue in this case provides, among other things, that

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[11] If an argument varies with the claim for a tax refund, the Court is without jurisdiction to consider it. According to the defendant, the Court is without jurisdiction to consider this argument because plaintiffs' claim for refund as presented to the IRS does not make this claim. *See* Doc. 20 at 10. "Numerous cases sustain the principle that the grounds on which a claim for a tax refund is made must be specifically set forth in the claim for refund itself, otherwise the court in a refund action is without jurisdiction to consider them." *Estate of Bird*, 534 F.2d 1214, 1219 (6th Cir. 1976). The Court finds that the defendant has received fair notice of the grievance.

> (v) Constructive additions. – (A) *Powers of Appointment.* – Except as provided in paragraph (b)(1)(v)(B) of this section, where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. . . .

Treasury Regulation § 26.2601-1(b)(1)(v)(A).[12] It was issued by the Commissioner pursuant to the authority of 26 U.S.C. § 7805(a), which authorizes the issuance of "all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." *Gerson*, 507 F.3d at 437-38. There is no dispute that the Regulation is an interpretive regulation and not a legislative regulation. *See Rowan Companies, Inc. v. United States*, 452 U.S. 247, 253 (1981) ("Because we therefore can measure the Commissioner's interpretation against a specific provision in the Code, we owe the interpretation less deference than a

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[12] Treasury Regulation § 26.2601-1(b)(1)(v)(D) contains several examples illustrating constructive additions and the application of paragraph (b)(1)(v)--the first of which presents a factual situation that is substantially similar to the situation presented by this case.

regulation issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision."). Defendant maintains that the Regulation interprets the language "added to the trust" in section 1433(b)(2)(A) to encompass property that is subject to a general power of appointment.

Plaintiffs cite two cases in support of their argument that this Court should find that the Regulation is invalid. In both cases, the courts held that a grandfathered trust passing pursuant to the *exercise* of a taxable general power of appointment to skip persons did not become subject to GST tax because the purpose of the irrevocable trust exception in the effective date statute was to provide an exception to the general rule and permit pre-existing estate plans imbedded in pre-existing irrevocable trusts to be grandfathered.

In the first case, *Simpson*, *supra*, an irrevocable trust gave the settlor's wife a general power of appointment by will. The widow exercised this power to give the corpus to her grandchildren. The Eighth Circuit found that the effective date provision allowed the settlor's wife to give the corpus to anyone she wanted without subjecting the transfer to the GST tax. *Simpson*, 183 F.3d at 814-15. In the second case cited by the plaintiffs, *Bachler*, *supra*, the Ninth Circuit followed the holding of the Eighth Circuit in *Simpson*, reversed the judgment of the district court, and construed the effective date provision in favor of the taxpayer. The Ninth Circuit distinguished *Peterson*, *supra*, on the ground that *Peterson* involved the lapse of a power of appointment whereas *Bachler* involved the exercise of a power of appointment.

According to the defendant's briefs filed prior to the *Gerson* decision, *Simpson*, *supra*, and *Bachler*, *supra*, are factually distinguishable on the ground that in the present matter the general power of appointment was not exercised. *See, e.g.* Doc. 17 at 24-25. Since the *Gerson* decision, the Court concludes that the distinction does not matter in the Sixth Circuit because the estate tax result is the same whether it's the *exercise* or *lapse* of a power of appointment. As the Sixth Circuit stated in *Gerson*, *supra*,

> . . . we disagree that exercise and lapse come to different ends. In the exercise of a power of appointment, two transfers occur. In the first transfer, the appointment power holder becomes the owner of the trust assets for tax purposes. *See* I.R.C. § 2041(a)(2) (including assets over which a decedent has a power of appointment in the decedent's taxable estate). In the second transfer, the holder transfers the assets to a skip person. If the second transfer occurs after the GST tax became effective, tax liability ensues. By contrast, in the lapse of a power of appointment, three transfers occur. The creation of the power of appointment again amounts to a first transfer, but because the holder of the power of appointment never uses the power, the assets flow back through the trust as a second transfer, reaching the skip person in the third transfer from the trust. *See* 26 C.F.R. § 26.2601-1(b)(1)(v)(A) ("[T]he value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse."). If

> the lapse occurs after 1985, liability results because assets were added to the trust corpus after September 25, 1985, per the second clause of the effective date provision. Tax Reform Act of 1986 § 1433(b)(2)(A).

507 F.3d at 440-41.

Plaintiffs attempt to get around the *Gerson* decision by arguing that the Regulation at issue in this case materially differs from the amended Regulation under review in *Gerson*. Doc. 38 at 3-5. According to the plaintiffs,

> [t]he specific Treasury Regulation language quoted and relied upon by the Sixth Circuit in *Gerson* to rule against the taxpayer simply does not exist in the earlier Treasury Regulation which applies to Plaintiffs in this case. Thus, the specific language treating the exercise, release, or lapse of a general power of appointment as constituting a taxable transfer is not included in the regulation applicable to Plaintiffs. In fact, there is no explicit language in the regulation applicable to Plaintiffs making such events a taxable transfer for purposes of the GST tax.

Doc. 38 at 3. Regulation § 26.2601-1(b)(1)(i), as it was written at the time applicable to the plaintiffs, did *not* contain the following language which, according to plaintiffs, was held to be decisive in the *Gerson* case:

> **(b) Exceptions -- (1) Irrevocable trusts -- (i) In general.** . . . Further, the rule in the [sentence described above] does not apply to a

> transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12. The transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985. See paragraph (b)(1)(v)(B) of this section regarding the treatment of the release, exercise, or lapse of a power of appointment that will result in a constructive addition to a trust. See
>
> § 26.2652-1(a) for the definition of a transferor.

In reaction to *Simpson*, *supra*, the IRS amended Regulation §26.2601-1(b)(1)(i) to specify that property transferred pursuant to a taxable general power of appointment is treated as a transfer by the power holder which subjects the property to GST tax. *See* Notice of Proposed Rulemaking on GST Issues, dated November 18, 1999, 64 FR 62997, 1999 WL 1039591 at 62998 ("the proposed regulations clarify the application of the effective date provisions when the exercise or lapse of a general power of appointment over an otherwise grandfathered trust results in property passing to a skip person"); *see also Estate of Gerson v. C.I.R.*, 127 T.C. No. 11, 127 T.C. 139, 150 (U.S.Tax Ct. Oct 24, 2006), *aff'd*, 507 F.3d 435 (6th Cir. 2007). Therefore, the plaintiffs contend that the defendant cannot rely on amended Regulation § 26.2601-1(b)(1)(i) as a basis for claiming that a GST tax should be imposed in the case at bar.

Unlike Regulation § 26.2601-1(b)(1)(i), the constructive additions regulation at issue in this case was not amended effective as of November 18, 1999. *Compare* Treasury Decision 8644, dated December 27, 1995, 60 FR 66898-02 with Notice of Proposed Rulemaking on GST Issues, dated November 18, 1999, 64 FR 62997, 1999 WL 1039591. Applying *Chevron* deference[13] to the agency's interpretation, the Court finds that Treasury Regulation § 26.2601-1(b)(1)(v)(A) is valid as a permissible construction of the effective date provision of the GST tax which does harmonize with the plain language of the statute. *National Muffler Dealers Ass'n, Inc. v. United States*, 440 U.S. 472, 477 (1979) (a regulation is not a reasonable statutory interpretation unless it "harmonizes with the plain language of the statute, its origin, and its purpose").

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[13] When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

467 U.S. at 842-43.

Assuming the Regulation is valid, it does apply to the facts in the case at bar

Plaintiffs argue that even if the constructive additions regulation is valid, the situation presented in the instant matter falls outside of the coverage of the Regulation and, therefore, qualifies for the grandfather provision.

There are two requirements in the Regulation which must be present in order to remove it from the protection otherwise offered by the effective date provision that grandfathers certain unmodified irrevocable trusts created before September 25, 1985. The first is that it only applies to any portion of a trust that "*remains in the trust* after the . . . release, exercise,. or lapse of a power of appointment" (emphasis added). The second element concerns whether "the release, exercise, or lapse is treated to any extent as a taxable transfer under [the gift or estate tax]." Contrary to plaintiffs' argument, the Court finds that both of these requirements are met in the case at bar.

Louise Blyth Timken died having a testamentary general power of appointment over the corpus of a marital deduction trust. When she died on October 3, 1998, Louise Blyth Timken had exercised her general power of appointment only to the extent of directing that the federal estate tax attributable to the inclusion of the Trust property in her gross estate be paid from the Trust property. She did not otherwise exercise the general power of appointment. Doc. 14 at ¶19; *see also* Doc. 14-7 (the Last Will and Testament and two codicils of Louise Blyth Timken). Section 26.2601-1(b)(1)(v)(A) as it was written at the time that

Louise Blyth Timken died provides that the release, exercise, or lapse of a general power of appointment created in a pre-September 25, 1985 document is not a transfer *under the trust*, but rather a transfer *by the holder* of the general power of appointment, which occurs when the exercise of the power becomes effective. John B. Atkins, *Balancing the GSTT Exemption and the Marital Deduction*, 14 Prob. & Prop. 16, 20 (July/Aug. 2000).

For the grandfather clause of the Tax Reform Act of 1986 § 1433(b)(2)(A) to except a trust from the GST tax, the trust must have been irrevocable on September 25, 1985, and the transfer cannot have been made from corpus added to the trust after that date. It is stipulated that the Trust became irrevocable upon the death of Henry H. Timken, Jr. Doc. 14 at ¶16. The Court agrees with defendant's argument that the transfers in this case were made from property constructively added to the trust, as outlined in section 26.2601-1(b)(1)(v)(A), after September 25, 1985; and, therefore, the exception to the GST tax that is authorized by the grandfather clause does not apply here. *See* Doc. 17 at 12. The Court holds that the lapse of the power by Louise Blyth Timken is both a constructive addition and a transfer that results in tax liability because assets were added to the trust corpus after September 25, 1985, per the second clause of the effective date provision. *Gerson*, 507 F.3d at 440-41; *see also Peterson*, 78 F.3d at 799 ("There is, therefore, no question that if the regulation is valid, the lapse of Mrs. Peterson's power of appointment is to be treated as an addition to the trust made after September 25, 1985, and the GST [tax] will apply to the transfer of that trust to Mr. Peterson's grandchildren."). The lapse of decedent's general power of appointment over the

marital trust corpus coupled with the Qualified Disclaimers filed by Edith M. Timken, Jane M. Timken, Barbara C. Timken, and John M. Timken, Jr. resulted in direct skips that are subject to the GST tax.

CONCLUSION

Based upon the foregoing, the United States' Motion for Summary Judgment (Doc. 16) is GRANTED and plaintiffs' Motion for Summary Judgment (Doc. 15) is DENIED upon the grounds that there is no genuine issue as to any material fact and the United States of America is entitled to a judgment as a matter of law on the merits of the complaint. Final judgment will be entered in favor of the United States of America.

IT IS SO ORDERED.

March 25, 2009
Date

/s/ John R. Adams
John R. Adams
U.S. District Judge

APPENDIX C

ADAMS, J.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

CASE NO. 5:04CV1188

[Filed March 25, 2009]

ESTATE OF LOUISE BLYTH TIMKEN (Deceased), et al.,	)
Plaintiffs,	)
v.	)
UNITED STATES OF AMERICA,	)
Defendant.	)

JUDGE JOHN R. ADAMS

JUDGMENT ENTRY

This Court, having filed its Memorandum of Opinion and Order, hereby enters judgment in favor of defendant, the United States of America, and against plaintiffs, the Estate of Louise Blyth Timken, Henry H. Timken, Jr. Trust Fund A, Henry H. Timken, Jr.

Trust, Fund A1A fbo Alexander C. Timken, Henry H. Timken, Jr. Trust, Fund A1B fbo Peter T. Toot, Henry H. Timken, Jr. Trust, Fund A1C fbo Elizabeth Burnham Timken, Henry H. Timken, Jr. Trust, Fund A2A fbo Susan Mead Matthews, Henry H. Timken, Jr. Trust Fund A2B fbo Thomas Wesley Matthews, Henry H. Timken, Jr. Trust, Fund A2C fbo Anna Virginie Corwin Timken, Henry H. Timken, Jr. Trust, Fund A2D fbo Nicholas Timken, Henry H. Timken, Jr. Trust, Fund A2E fbo John Henry Timken, and Henry H. Timken, Jr. Trust, Fund A2F fbo Stuart Morgan Timken, on the complaint.

IT IS SO ORDERED.

March 25, 2009
Date

/s/ John R. Adams
John R. Adams
U.S. District Judge

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 09-3650

[Filed June 16, 2010]

ESTATE OF LOUISE BLYTH TIMKEN, (DECEASED), ET AL.,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

ORDER

BEFORE: SILER and ROGERS, Circuit Judges; and BELL,* District Judge.

The court having received a petition for rehearing en banc, which was circulated to all active** judges of

* Hon. Robert Holmes Bell, United States District Judge for the Western District of Michigan, sitting by designation.

** Chief Judge Batchelder recused herself from participation in this ruling.

this court, none of whom requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

/s/Leonard Green
Leonard Green, Clerk

APPENDIX E

OCT. 22 TAX REFORM ACT OF 1986

P.L. 99-514
Sec. 1433

SEC. 1433. EFFECTIVE DATES.

(a) GENERAL RULE. — Except as provided in subsection (b), the amendments made by this part shall apply to any generation-skipping transfer (within the meaning of section 2611 of the Internal Revenue Code of 1986) made after the date of the enactment of this Act.

(b) SPECIAL RULES. —

(1) TREATMENT OF CERTAIN INTER VIVOS TRANSFERS MADE AFTER SEPTEMBER 25, 1985. — For purposes of subsection (a) (and chapter 13 of the Internal Revenue Code of 1986 as amended by this part), any inter vivos transfer after September 25, 1985, and on or before the date of the enactment of this Act shall be treated as if it were made on the 1st day after the date of enactment of this Act.

(2) EXCEPTIONS. — The amendments made by this part shall not apply to —

(A) any generation-skipping transfer under a trust which was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985,

(B) any generation-skipping transfer under a will executed before the date of the enactment of this Act if the decedent dies before January 1, 1987, and

(C) any generation-skipping transfer —

(i) under a trust to the extent such trust consists of property included in the gross estate of a decedent (other than property transferred by the decedent during his life after the date of the enactment of this Act), or reinvestments thereof, or

(ii) which is a direct skip which occurs by reason of the death of any decedent;

but only if such decedent was, on the date of the enactment of this Act, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of his death.

(3) TREATMENT OF CERTAIN TRANSFERS TO GRANDCHILDREN. — For purposes of chapter 13 of the Internal Revenue Code of 1986, the term "direct skip" shall not include any transfer before January 1, 1990, from a transferor to a grandchild of the transferor to the extent that the aggregate transfers from such transferor to such grandchild do not exceed $2,000,000.

(c) REPEAL OF EXISTING TAX ON GENERATION-SKIPPING TRANSFERS. —

(1) IN GENERAL. — In the case of any tax imposed by chapter 13 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act), such tax (including interest, additions to tax, and additional amounts) shall not be assessed and if assessed, the

assessment shall be abated, and if collected, shall be credited or refunded (with interest) as an overpayment.

(2) WAIVER OF STATUTE OF LIMITATIONS. — If on the date of the enactment of this Act (or at any time within 1 year after such date of enactment) refund or credit of any overpayment of tax resulting from the application of paragraph (1) is barred by any law or rule of law, refund or credit of such overpayment shall, nevertheless, be made or allowed if claim therefore is filed before the date 1 year after the date of the enactment of this Act.

(d) ELECTION FOR CERTAIN TRANSFERS BENEFITING GRANDCHILD. —

(1) IN GENERAL. — For purposes of chapter 13 of the Internal Revenue Code of 1986 (as amended by this Act) and subsection (b) of this section, any transfer in trust for the benefit of a grandchild of a transferor shall be treated as a direct skip if —

(A) the transfer occurs before the date of enactment of this Act,

(B) the transfer would be a direct skip except for the fact that the trust instrument provides that, if the grandchild dies before vesting of the interest transferred, the interest is transferred to the grandchild's heir (rather than the grandchild's estate), and

(C) an election under this subsection applies to such transfer.

Any transfer treated as a direct skip by reason of the preceding sentence shall be subject to Federal estate tax on the grandchild's death in the same manner as if the contingent gift over had been to the grandchild's estate.

(2) ELECTION. — An election under paragraph (1) shall be made at such time and in such manner

as the Secretary of the Treasury or his delegate may prescribe.

26 C.F.R. § 26.2601-1 Treas. Reg. § 26.2601-1

* * *

(v) Constructive additions--(A) Powers of Appointment. Except as provided in paragraph (b)(1)(v)(B) of this section, where any portion of a trust remains in the trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer under chapter 11 or chapter 12, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer under chapter 11 or chapter 12. See § 26.2652-1 for rules for determining the identity of the transferor of property for purposes of chapter 13.

(B) Special rule for certain powers of appointment. The release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in section 2041(b)) is not treated as an addition to a trust if--

(1) Such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under paragraph (b)(1) of this section; and

(2) In the case of an exercise, the power of appointment is not exercised in a manner that may postpone or

suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of this paragraph (b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

(C) Constructive addition if liability is not paid out of trust principal. Where a trust described in paragraph (b)(1) of this section is relieved of any liability properly payable out of the assets of such trust, the person or entity who actually satisfies the liability is considered to have made a constructive addition to the trust in an amount equal to the liability. The constructive addition occurs when the trust is relieved of liability (e.g., when the right of recovery is no longer enforceable). But see § 26.2652-1(a)(3) for rules involving the application of section 2207A in the case of an election under section 2652(a)(3).

(D) Examples. The following examples illustrate the application of this paragraph (b)(1)(v):

Example 1. Lapse of a power of appointment. On June 19, 1980, T established an irrevocable trust with a corpus of $500,000. The trust instrument provides that the trustee shall distribute the entire income from the trust annually to T's spouse, S, during S's life. At S's death, the remainder is to be distributed to T and S's grandchild, GC. T also gave S a general power of appointment over one-half of the trust assets. On December 21, 1989, when the value of the trust corpus is $1,500,000, S died without having exercised the general power of appointment. The value of one-half of the trust corpus, $750,000 ($1,500,000 x .5) is included in S's gross estate under section 2041(a) and is subject to tax under Chapter 11. Because the value of one-half of the trust corpus is subject to tax under Chapter 11 with respect to S's estate, S is treated as the transferor of that property for purposes of Chapter 13 (see section 2652(a)(1)(A)). For purposes of the generation-skipping transfer tax, the lapse of S's power of appointment is treated as if $750,000 ($1,500,000 x .5) had been distributed to S and then transferred back to the trust. Thus, S is considered to have added $750,000 ($1,500,000 x .5) to the trust at the date of S's death. Because this constructive addition occurred after September 25, 1985, 50 percent of the corpus of the trust became subject to Chapter 13 at S's death.

Example 2. Multiple actual additions. On June 19, 1980, T established an irrevocable trust with a principal of $500,000. The trust instrument provides that the trustee shall distribute the entire income from the trust annually to T's spouse, S, during S's life. At S's death, the remainder is to be distributed to GC, the grandchild of T and S. On October 1, 1985, when the trust assets were valued at $800,000, T added $200,000 to the trust. After the transfer on October 1,

1985, the allocation fraction was .2 ($200,000/$1,000,000). On December 21, 1989, when the value of the trust principal is $1,000,000, T adds $1,000,000 to the trust. After this addition, the new allocation fraction is 0.6 ($1,200,000/$2,000,000). The numerator of the fraction is the value of that portion of trust assets that were subject to chapter 13 immediately prior to the addition (by reason of the first addition), $200,000 (.2 x $1,000,000), plus the value of the second transfer, $1,000,000, which equals $1,200,000. The denominator of the fraction, $2,000,000, is the total value of the trust assets immediately after the second transfer. Thus, 60 percent of the principal of the trust becomes subject to chapter 13.

Example 3. Entire portion of trust subject to lapsed power is treated as an addition. On September 25, 1985, B possessed a general power of appointment over the assets of an irrevocable trust that had been created by T in 1980. Under the terms of the trust, B's power lapsed on July 20, 1987. For Federal gift tax purposes, B is treated as making a gift of ninety-five percent (100% - 5%) of the value of the principal (see section 2514). However, because the entire trust was subject to the power of appointment, 100 percent (that portion of the trust subject to the power) of the assets of the trust are treated as a constructive addition. Thus, the entire amount of all generation-skipping transfers occurring pursuant to the trust instrument after July 20, 1987, are subject to chapter 13.

Example 4. Exercise of power of appointment in favor of another trust. On March 1, 1985, T established an irrevocable trust as defined in paragraph (b)(1)(ii) of this section. Under the terms of the trust

instrument, the trustee is required to distribute the entire income annually to T's child, C, for life, then to T's grandchild, GC, for life. GC has the power to appoint any or all of the trust assets to Trust 2 which is an irrevocable trust (as defined in paragraph (b)(1)(ii) of this section) that was established on August 1, 1985. The terms of Trust 2's governing instrument provide that the trustee shall pay income to T's great grandchild, GGC, for life. Upon GGC's death, the remainder is to be paid to GGC's issue. GGC was alive on March 1, 1985, when Trust 1 was created. C died on April 1, 1986. On July 1, 1987, GC exercised the power of appointment. The exercise of GC's power does not subject future transfers from Trust 2 to tax under chapter 13 because the exercise of the power in favor of Trust 2 does not suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date of creation of Trust 1, extending beyond the life of GGC (a beneficiary under Trust 2 who was in being at the date of creation of Trust 1) plus a period of 21 years. The result would be the same if Trust 2 had been created after the effective date of chapter 13.

Example 5. Exercise of power of appointment in favor of another trust. Assume the same facts as in Example 4, except that GGC was born on March 28, 1986. The valid exercise of GC's power in favor of Trust 2 causes the principal of Trust 1 to be subject to chapter 13, because GGC was not born until after the creation of Trust 1. Thus, such exercise may suspend the vesting, absolute ownership, or power of alienation of an interest in the trust principal for a period, measured from the date of creation of Trust 1, extending beyond the life of GGC (a beneficiary under

Trust 2 who was not a life in being at the date of creation of Trust 1).

Example 6. Extension for the longer of two periods. Prior to the effective date of chapter 13, GP established an irrevocable trust under which the trust income was to be paid to GP's child, C, for life. C was given a testamentary power to appoint the remainder in further trust for the benefit of C's issue. In default of C's exercise of the power, the remainder was to pass to charity. C died on February 3, 1995, survived by a child who was alive when GP established the trust. C exercised the power in a manner that validly extends the trust in favor of C's issue until the latter of May 15, 2064 (80 years from the date the trust was created), or the death of C's child plus 21 years. C's exercise of the power is a constructive addition to the trust because the exercise may extend the trust for a period longer than the permissible periods of either the life of C's child (a life in being at the creation of the trust) plus 21 years or a term not more than 90 years measured from the creation of the trust. On the other hand, if C's exercise of the power could extend the trust based only on the life of C's child plus 21 years or only for a term of 80 years from the creation of the trust (but not the later of the two periods) then the exercise of the power would not have been a constructive addition to the trust.

Example 7. Extension for the longer of two periods. The facts are the same as in Example 6 except local law provides that the effect of C's exercise is to extend the term of the trust until May 15, 2064, whether or not C's child predeceases that date by more than 21 years. C's exercise is not a constructive addition to the trust because C exercised the power in

a manner that cannot postpone or suspend vesting, absolute ownership, or power of alienation for a term of years that will exceed 90 years. The result would be the same if the effect of C's exercise is either to extend the term of the trust until 21 years after the death of C's child or to extend the term of the trust until the first to occur of May 15, 2064 or 21 years after the death of C's child.

§ 26.2601-1 Effective dates.

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(b) *Exceptions*—(1) *Irrevocable trusts*—(i) *In general.* The provisions of chapter 13 do not apply to any generation-skipping transfer under a trust (as defined in section 2652(b)) that was irrevocable on September 25, 1985. The rule of the preceding sentence does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985. See paragraph (b)(1)(iv) of this section for rules for determining the portion of the trust that is subject to the provisions of chapter 13. Further, the rule in the first sentence of this paragraph (b)(1)(i) does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12. The transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985. See paragraph (b)(1)(v)(B) of this section regarding the treatment of the release, exercise, or lapse of a power of appointment that will result in a constructive addition to a trust. See § 26.2652-1(a) for the definition of a transferor.

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